

# QUEST Economic Update | April 2023

**Labor markets remain tight, some signs the economy may be starting to cool; uncertain path forward for interest rates**



The Federal Open Market Committee (FOMC) is expected to raise the federal funds target rate by 25 basis points when it next meets on May 2-3. There is less clarity around what comes next. If inflation is the top priority, the FOMC might raise the target rate further; if it views the economy as starting to cool, especially the tight labor markets, it may have hold off on additional rate increases. Market expectations are for the FOMC to be in a holding pattern after the May increase until Fall 2023.

The March Consumer Price Index (CPI) report appears to suggest that the resurgence in inflationary pressures seen in January and February may have subsided. The overall CPI increased by 0.1% in March and was up 5.0% from a year ago. However, the core CPI, which excludes volatile energy and food prices, was up 5.6% from a year ago, slightly more than the 12-month increase reported for February.

The labor markets remain tight. The March unemployment rate was 3.5%. However, the number of additional jobs in March was 236,000, below the gains from the prior several months. Job openings for February fell by 0.6 million. Weekly new UI claims have been gradually increasing since mid-January 2023 and are near the average level from 2015 through 2019 (i.e., pre-pandemic).

The continued tightness in the labor markets may, in part, reflect the relatively strong economic performance during the first quarter. While the first estimate of first quarter GDP will not be released until next week, the Federal Reserve Bank of Atlanta's GDPNow forecast expects real annualized GDP during the first quarter to be 2.5%, suggesting the US economy's resilience continues. Many forecasts see a mild recession beginning in the second half of this year.

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 4/21/2023

## OVERALL US ECONOMY

Economic growth is expected to slow in 2023, with some forecasts suggesting a possible several-quarter recession beginning in the second half of this year. The recent bank failures, combined with loosening labor markets and still-elevated inflation, make the path ahead for interest rates more uncertain.

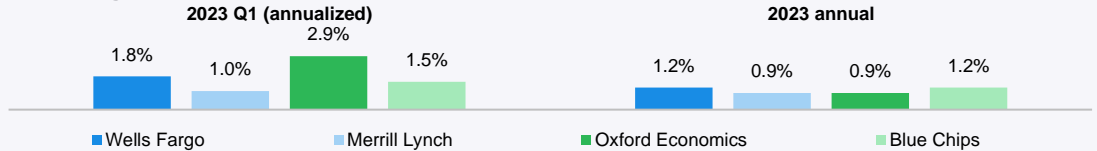
**1.0% to 2.9% growth**

expected for 2023 Q1 (annualized)

**0.9% to 1.2% growth**

expected for 2023

### US GDP growth forecast



## LABOR MARKETS

Labor markets remain tight, with the March unemployment rate falling to 3.5% from 3.6% in February. Some signs of loosening include March jobs gains and February job openings falling off, and weekly new UI claims gradually increasing to pre-pandemic levels since mid-January 2023.

**606k**

job gain

on average in 2021

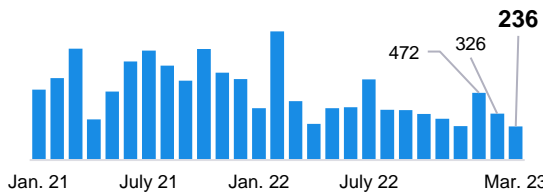
**399k**

job gain

on average in 2022

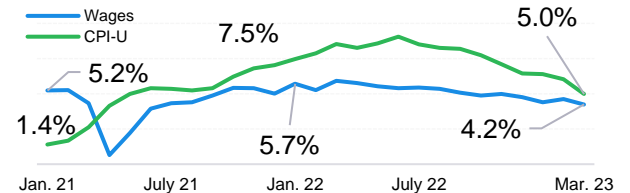
### Nonfarm payroll employment

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



### Hourly wages and CPI-U

Change from a year earlier, CPI - not seasonally adjusted, Wages - seasonally adjusted

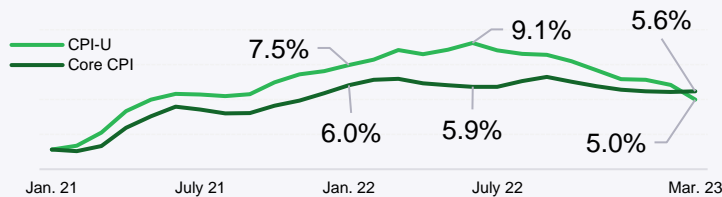


## INFLATION / INTEREST RATES

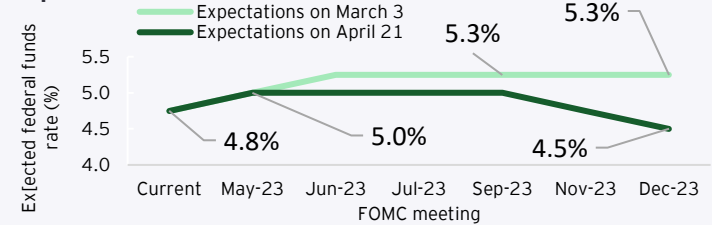
The March inflation numbers appear to provide a respite from the inflationary pressures seen in January and February. However, inflation remains elevated and appears to be falling more gradually than many had forecast. Market expectations are for the FOMC to increase its target rate by 25 basis points at its May 2-3 meeting and then hold until Fall 2023.

### CPI-U and core CPI

Change from a year earlier, not seasonally adjusted

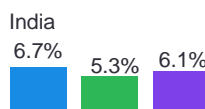
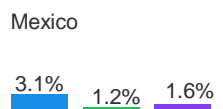
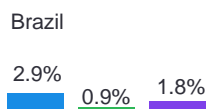
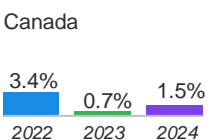
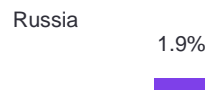
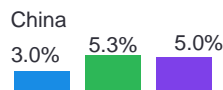
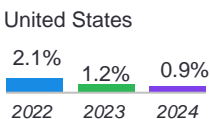


### Expected federal funds rate over 2023



## GLOBAL GROWTH

Forecasts suggest slowing global economic growth in 2023, especially in the United States and the Eurozone. China's economy appears to be picking up speed.



### Upcoming economic data releases

- ▶ GDP for the first quarter of 2023 (advanced/initial estimate), April 27
- ▶ Job openings for March, May 2
- ▶ Interest rates, Federal Open Markets Committee (FOMC) meeting, May 2-3
- ▶ Employment situation for April, May 5
- ▶ Consumer Price Index for April, May 10
- ▶ Producer Price Index for April, May 11
- ▶ Housing starts for April, May 17

Source: Blue Chip Economic Indicators (Vol. 48, No. 4, April 10, 2023).

## Overall US economy

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The US economy continues to face significant headwinds. The bank failures from earlier this year have reduced liquidity and may be slowing the economy, at least to an extent. The resurgence of inflationary pressures in January and February appears to have subsided in March, but inflation remains elevated and is coming down more slowly than many anticipated. A further complication is the continued tightness in labor markets, although there are some signs of loosening.

All of these factors make for a highly uncertain path forward for the FOMC's interest rate policy. Market expectations are for the FOMC to increase its target rate by 25 basis points at its May 2-3 meeting, stay at that level until Fall 2023 and then begin lowering rates.

Signs of a slow-down are not yet apparent. The March unemployment rate fell to 3.5% from 3.6% in February but remains well below the

roughly 4.5% rate that economists view as consistent with full employment. March job gains were 236,000, lower than the 326,000 in February, and the average job gains of 399,000 in 2022.

The Conference Board's consumer confidence index rose slightly to 104.2 from 103.4 in February. Housing starts fell 0.8% in March and are 20.1% below February 2022. The ISM Manufacturing Employment Index fell to 46.9 in March from 49.1 in February (values below 50 indicate contraction).

The Atlanta Fed's GDPNow Tracker estimates first quarter real annualized GDP growth to be 2.5%. Despite the economy's resilience during the second half of 2022 and the beginning of 2023, some forecasters see a several-quarter recession beginning in the second half of this year.

## Labor market

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US labor markets remain tight. The March unemployment rate fell to 3.5% from 3.6% in February. The unemployment rate is 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 in the range of 4.4% to 4.5%. The economy added 236,000 jobs in March, below the 326,000 added in February and the average job gains of 399,000 in 2022, but job gains remain at a level that are not likely to increase the unemployment rate significantly. Weekly UI claims have been gradually increasing since mid-January and are now back to pre-pandemic levels. Job openings in February fell by 0.6 million.

The rate of labor force participation rose by 0.1 percentage point in March to 62.6%, 0.8% below the pre-pandemic level. The March underemployment rate, which averaged 8.7% from 2015 through 2019,

rose to 6.7% from 6.8% in February. Average hourly earnings were up in March by 4.2% from a year ago, a pace well below the rise in consumer prices but above the Federal Reserve's 2% target inflation rate.

Despite the current tightness of the labor markets, many forecasters see the unemployment rate rising by roughly one percentage point or more over the next year. The forecasts suggest that the Federal Reserve's higher interest rates will begin to take hold and slow the economy within the next quarter or two.

## Inflation

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The March inflation numbers appear to suggest that inflation's resurgence in January and February has at least abated. The overall CPI rose by 5.0% in March following its 6.0% increase in February, down from its high of 9.1% (y/y) in June. The monthly March CPI rose 0.1%, following its 0.4% increase in February. The core CPI, which excludes energy and food prices, rose by 5.6% (y/y) in March, slightly above its 5.5% (y/y) increase in February. The monthly core CPI rose by 0.4% in March. Notwithstanding the favorable March inflation numbers, inflation remains elevated and appears to be falling more gradually than many had forecast.

The price index for shelter, which rose 0.6%, was the largest contributor to the monthly increase in the overall CPI. This increase in shelter prices more than offset the decline in the price index for energy. The indexes for

motor vehicle insurance, airline fares, household furnishings and operations, and new vehicles also increased. The index for medical care and the index for used cars and trucks were among those that decreased.

The market expects the FOMC will raise the federal funds target rate by 25 basis points at its May 2-3 meeting, hold that rate until Fall 2023, and then begin lowering the target rate. That said, there is significant uncertainty in this outlook.

## Global growth

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The global economy is expected to slow in 2023, with growth in the 1.5% 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. The Ukraine conflict continues to contribute to uncertainty, but the Eurozone may have benefited from this year's mild winter.

Forecasts for economic growth have moved up for the United Kingdom,

Mexico, China and Russia. As China comes out of the COVID lockdowns and ensuing COVID surge, its economy appears to be experiencing steady growth. Another factor creating uncertainty in the global economic climate is the path of inflation and the potential that associated global monetary tightening may create significant economic headwinds, which will increase the likelihood of a global recession.

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