

# QUEST Economic Update | May 2023



## Robust consumption growth and tight labor markets despite persistent inflation and bank failures; Fed likely to catch its breath after historic rate hike pace

The US economy remains resilient amidst persistent inflation, further bank failures and uncertainty about the debt ceiling. First quarter gross domestic product (GDP) grew at an annualized rate of 1.1% buoyed by personal consumption, which grew at a 3.7% annualized rate in the first quarter, mostly occurring in January. April retail spending increased by 0.4% after two consecutive months of declines.

The 3.4% unemployment rate is at a historic low, indicating a tight labor market. There are, however, some signs of loosening labor markets. The economy added 253,000 jobs in April, higher than the revised 165,000 jobs added in March but below the 2023 average of 285,000. 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 April Consumer Price Index (CPI) report suggests that the resurgence in inflationary pressures seen in January and February may have subsided, but inflation remains high. The overall CPI increased by 0.4% in April and was up 4.9% from a year ago. The core CPI, which excludes volatile energy and food prices, was up 5.5% from a year ago, slightly less than the 12-month increase reported for March.

Facing headwinds from significant bank failures and uncertainty with the debt ceiling impasse, the Federal Open Market Committee (FOMC) raised the federal funds target rate by 25 basis points at its May 2-3 meeting. However, there is less clarity around what comes next. Market expectations are for the FOMC to be in a holding pattern until Fall 2023 and possibly lower rates after that. Even without another rate increase, this has been the fastest rate hike cycle since the early 1980s.

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 5/22/2023

## 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.

### 0.4% to 1.9% growth

expected for 2023 Q2 (annualized)

### 0.5% to 1.3% growth

expected for 2023

### US GDP growth forecast



## LABOR MARKETS

Labor markets remain tight, with the April unemployment rate falling to 3.4% from 3.5% in March. Some signs of loosening include March 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

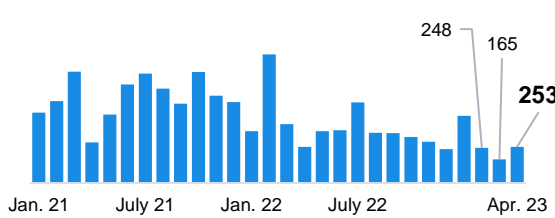
on average in 2022

### 285k job gain

on average in 2023

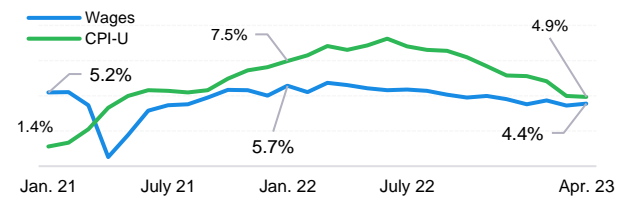
### Nonfarm payroll employment

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

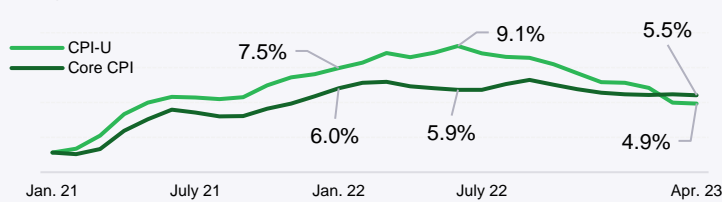


## INFLATION / INTEREST RATES

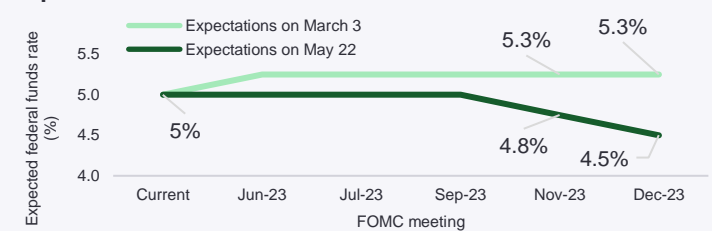
The April inflation numbers appear to suggest that the inflationary pressures seen in January and February have subsided. However, inflation remains elevated and appears to be falling more gradually than many had forecast. Market expectations are for the FOMC to pause further rate increases until Fall 2023.

### CPI-U and core CPI

Change from a year earlier, not seasonally adjusted

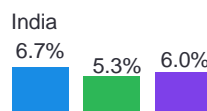
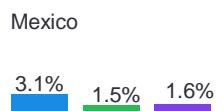
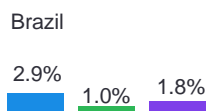
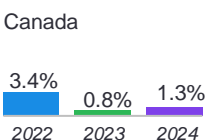
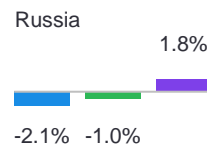
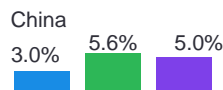
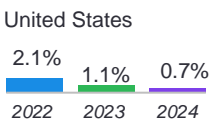


### Expected federal funds rate over 2023



## 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.



Source: Blue Chip Economic Indicators (Vol. 48, No. 5, May 10, 2023).

### Upcoming economic data releases

- ▶ GDP for the first quarter of 2023 (second estimate), May 25
- ▶ Personal income and outlays for April, May 26
- ▶ Job openings for April, May 31
- ▶ Employment situation for May, June 2
- ▶ Consumer Price Index for May, June 13
- ▶ Producer Price Index for May, June 14
- ▶ Interest rates, Federal Open Markets Committee (FOMC) meeting, June 13-14

## Overall US economy

The US economy continues to face significant headwinds. The economy experienced another bank failure in May. Resulting reduced liquidity may slow the economy, at least to an extent. The resurgence of inflationary pressures in January and February appears to have subsided in March and April, 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 these factors make for a highly uncertain path forward for the FOMC's interest rate policy following its increase in the federal funds target rate by 25 basis points at its May 2-3 meeting. Market expectations are for the target rate to stay at this level until Fall 2023, after which the FOMC is expected to begin to lower the target rate.

Signs of a slow-down are not yet apparent. The April unemployment rate fell to 3.4% from 3.5% in March and remains well below the roughly

### Labor market

US labor markets remain tight. The April unemployment rate fell to 3.4% from 3.5% in March. 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 253,000 jobs in April, above the 165,000 jobs added in March but below the average job gains of 290,000 in the prior six months. Job gains, however, remain at a level that is not likely to increase the unemployment rate significantly. Weekly UI claims have been gradually increasing since mid-January and are now close to pre-pandemic levels. Job openings in March fell by 0.4 million.

The rate of labor force participation did not change significantly at 62.6% in April, 0.8% below the pre-pandemic level. The April underemployment rate, which averaged 8.7% from 2015 through 2019, fell to 6.6% from

### Inflation

The April inflation numbers suggest that the inflation resurgence seen in January and February has at least abated. The overall CPI rose by 4.9% in April following its 5.0% increase in March, down from its high of 9.1% (y/y) in June. The monthly April CPI rose 0.4%, following its 0.1% increase in March. The core CPI, which excludes energy and food prices, rose by 5.5% (y/y) in April, slightly below its 5.6% (y/y) increase in March. The monthly core CPI rose by 0.4% in March. Notwithstanding the favorable March and April inflation numbers, inflation remains elevated and appears to be falling more gradually than many had forecast.

The price index for shelter, which rose 0.4%, was the largest contributor to the monthly increase in the overall CPI. The indexes for food away from home, energy commodities, apparel, used cars and trucks and medical care commodities also increased. The indexes for food at home,

## Global growth

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.

Nevertheless, forecasts for economic growth have moved up for the

4.4%-4.5% range that economists view as consistent with full employment. April job gains were 253,000, which was higher than the 165,000 job gains in March, but lower than the average job gains of 290,000 in the prior six months.

The Conference Board's consumer confidence index fell to 101.3 from 104.0 in March. Housing starts rose 2.2% in April and are 21.8% below April 2022. The ISM Manufacturing Employment Index rose to 47.1 in April from 46.9 in March (values below 50 indicate contraction).

First quarter real GDP grew at an annualized rate of 1.1% buoyed by personal consumption that grew at a 3.7% annualized rate, mostly occurring in January. 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.

6.7% in March. Average hourly earnings were up in April by 4.4% 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.

energy services, new vehicles, transportation service, and medical care services were among those that decreased.

The market expects the FOMC will pause any action on its interest rate targets until Fall 2023, and then begin lowering the target rate. That said, there is significant uncertainty in this outlook.

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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## Contacts

For more information, contact: [robert.carroll@ey.com](mailto:robert.carroll@ey.com)  
[james.mackie@ey.com](mailto:james.mackie@ey.com), [brandon.pizzola@ey.com](mailto:brandon.pizzola@ey.com)

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