# QUEST Economic Update | June 2023

**Robust consumption growth and tight labor markets continue despite persistent inflation and tightening credit after bank failures**

The US economy remains resilient amidst persistent inflation, tightening credit and the fastest cycle of interest rate increases since the early 1980s. The Federal Reserve left interest rates unchanged at its June 13-14 meeting but signaled it might raise interest rates possibly two more times this year as it continues to evaluate how the economy is reacting to its 10 consecutive rate increases.

The May Consumer Price Index (CPI) report provided a somewhat mixed view of inflation. The overall CPI rose 0.1% in May and 4.0% from 12 months ago, suggesting progress on the inflation front. However, the core CPI, which excludes the more volatile energy and food prices, rose 0.4% in May and 5.3% from 12 months ago, suggesting that inflation pressures remain elevated. The April personal consumption expenditure (PCE) price index, the measure on which the Federal Reserve focuses when determining monetary policy, rose 0.4% in April, the same as in March, and rose by 4.4% from 12 months ago as compared to 4.2% for the 12-month increase reported for March.

First quarter gross domestic product (GDP) grew at an annualized rate of 1.3%, buoyed by personal consumption, which grew at a 3.7% annualized rate in the first quarter, mostly occurring in January. Retail spending increased in both April and May after two consecutive months of decline, a sign of the US economy's resilience.

The Federal Reserve's June economic projections portrayed a somewhat more promising course for the US economy in 2023 with a higher forecast for real GDP and a lower unemployment rate than in its March economic projections, although it also forecasted somewhat higher inflation and a higher target rate.

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

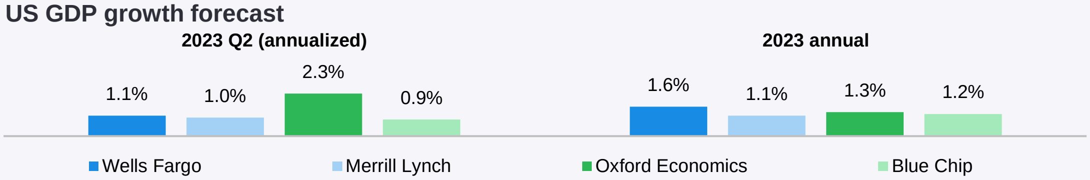
## OVERALL US ECONOMY

Economic growth is expected to slow in 2023, with some forecasts suggesting a possible recession over several quarters, beginning in the second half of this year. Nevertheless, the economic picture appears to have improved over the past several months.

**0.9% to 2.3%** growth expected for 2023 Q2 (annualized)

**1.1% to 1.6%** growth expected for 2023

### US GDP growth forecast




## LABOR MARKETS

Labor markets remain tight, with the May unemployment rate rising to 3.7% from 3.4% in April. Some signs of loosening include weekly new UI claims rising above pre-pandemic levels for several weeks and job openings falling from their highs in early 2022.

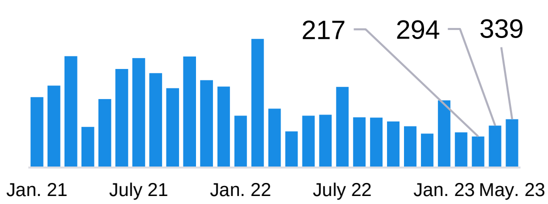
**606k** job gain on average in 2021

**399k** job gain on average in 2022

**314k** job gain on average in 2023

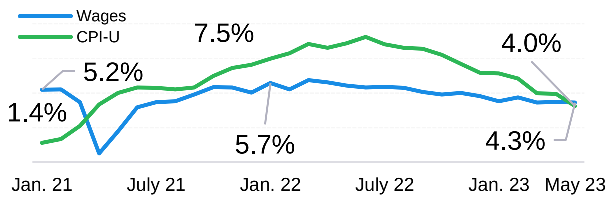
### Nonfarm payroll employment

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

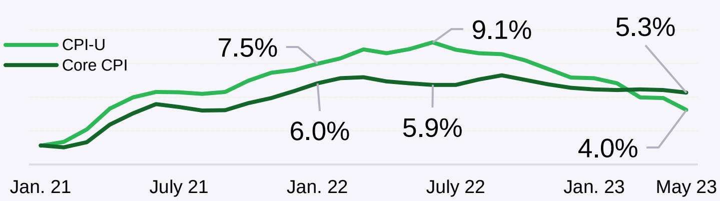



## INFLATION / INTEREST RATES

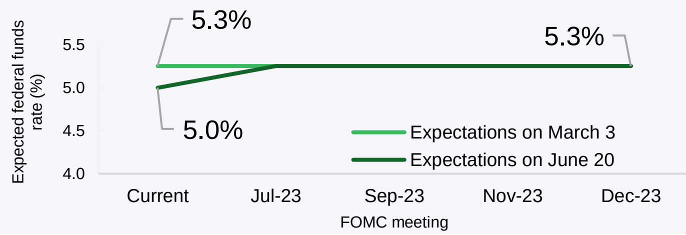
The May inflation numbers carried a mixed message. Overall inflation appears to have continued to subside, albeit slowly. In contrast, core inflation, which excludes volatile energy and food prices, remains elevated. Market expectations are for the Federal Reserve to raise interest rates at its July 25-26 meeting and hold them constant through the end of 2023.

### CPI-U and core CPI

Change from a year earlier, not seasonally adjusted

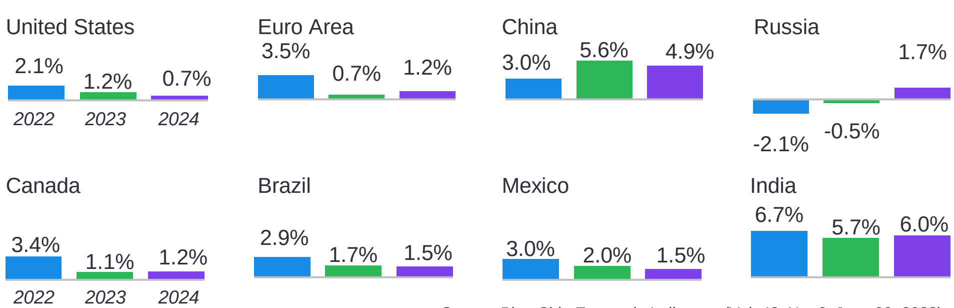



### Expected federal funds rate over 2023




## GLOBAL GROWTH

Forecasts, while generally still suggesting slowing global economic growth in 2023, have improved over the past few months. China's economy appears to be facing renewed challenges.




Source: Blue Chip Economic Indicators (Vol. 48, No. 6, June 09, 2023).

### Upcoming economic data releases

- GDP for the first quarter of 2023 (third estimate), June 29
- Job openings for May, July 6
- Employment situation for June, July 7
- Consumer Price Index for June, July 12
- Producer Price Index for June, July 13
- Housing starts, July 19
- Interest rates, Federal Open Markets Committee (FOMC) meeting, July 25-26

## Overall US economy

The US economy continues to face significant headwinds. The economy experienced another bank failure in May. The resulting reduced liquidity may slow the economy to an extent. The resurgence of inflationary pressures in January and February appears to have subsided in the subsequent months, 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.

With all these factors in play, the FOMC left the federal funds rate target unchanged at its June 13-14 meeting. During Federal Reserve Chairman Jay Powell's press conference, he emphasized nearly all FOMC participants expected more hikes later this year. Market expectations are for a 25-basis point hike at its July 25-26 meeting and to pause for the rest of 2023.

Signs of a slow-down are not yet apparent. The May unemployment rate rose to 3.7% from 3.4% in April and remains well below the roughly 4.4%-4.5% range that economists view as consistent with full employment. May job gains were 339,000, which was higher than the 294,000 job gains in April, and higher than the average job gains of 302,000 in the prior sixth months.

The Conference Board's consumer confidence index fell to 102.3 from 103.7 in April. Housing starts rose 2.2% in April and are 22.3% below April 2022. The ISM Manufacturing Employment Index rose to 51.4 in May from 50.2 in April (values below 50 indicate contraction).

First quarter real GDP grew at an annualized rate of 1.3%, buoyed by personal consumption, which grew at a 3.8% annualized rate, mostly occurring in January. Retail spending rebounded in April and May after being nearly flat for two months. Consumer spending also picked up in April. The better-than-expected performance had caused some forecasters to lift their economic forecasts for the latter half of 2023, but some forecasters still see a recession of several quarters, beginning in the second half of this year, as a possibility.

## Labor market

US labor markets remain tight. The May unemployment rate rose to 3.7% from 3.4% in April. 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 339,000 jobs in May, above the 294,000 jobs added in April and higher than the average job gains of 302,000 in the prior six months. Weekly UI claims have been gradually increasing since mid-January and are now close to pre-pandemic levels. Job openings in April rose by 0.4 million but are well below their highs from early 2022.

The rate of labor force participation remained at 62.6% in May, 0.8 percentage point below the pre-pandemic level. The May underemployment rate, which averaged 8.7% from 2015 through 2019, rose to 6.7% from 6.6% in April. Average hourly earnings were up in May by 4.3% from a year ago, a pace above the rise in consumer prices and 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

The May CPI report provided a mixed message on inflation, with overall inflation suggesting that inflationary pressures continue to subside, albeit at a slow pace, but core inflation suggesting greater stickiness in prices. The overall CPI rose by 4.0% in May following its 4.9% increase in April. The monthly May CPI rose 0.1%, following its 0.4% increase in April. The core CPI, which excludes the more volatile energy and food prices, rose by 5.3% (y/y) in May, slightly below its 5.5% increase in April. The monthly core CPI rose by 0.4% in May.

The price index for shelter, which rose 0.6%, was the largest contributor to the monthly increase in the overall CPI. The indices for food at home, food away from home, apparel, medical care commodities and transportation services also increased. The indices for energy services, energy commodities, new vehicles, used cars and trucks, transportation services and medical care services were among those that decreased.

The market expects that the FOMC will increase the federal funds target rate by 25 basis points at its July 25-26 meeting, hold rates steady for the remainder of 2023 and begin lowering them in early 2024.

## 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. That said, recent forecasts are somewhat less pessimistic than a few months ago, although recession risks remain in the United States, United Kingdom and Eurozone.

Although China showed significant strength coming out of its COVID lockdowns and the ensuing COVID surge, its economy now appears to be experiencing some headwinds due to difficulties in its real estate sector, high debt levels and dwindling consumer demand. In contrast to the United States and Europe, inflation is currently not a problem in China, and its central bank recently lowered interest rates to help spur economic growth.

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## Contacts

For more information, contact: robert.carroll@ey.com
andrew.phillips@ey.com, brandon.pizzola@ey.com

SCORE No. XX0000
1909-3266768
ED None