

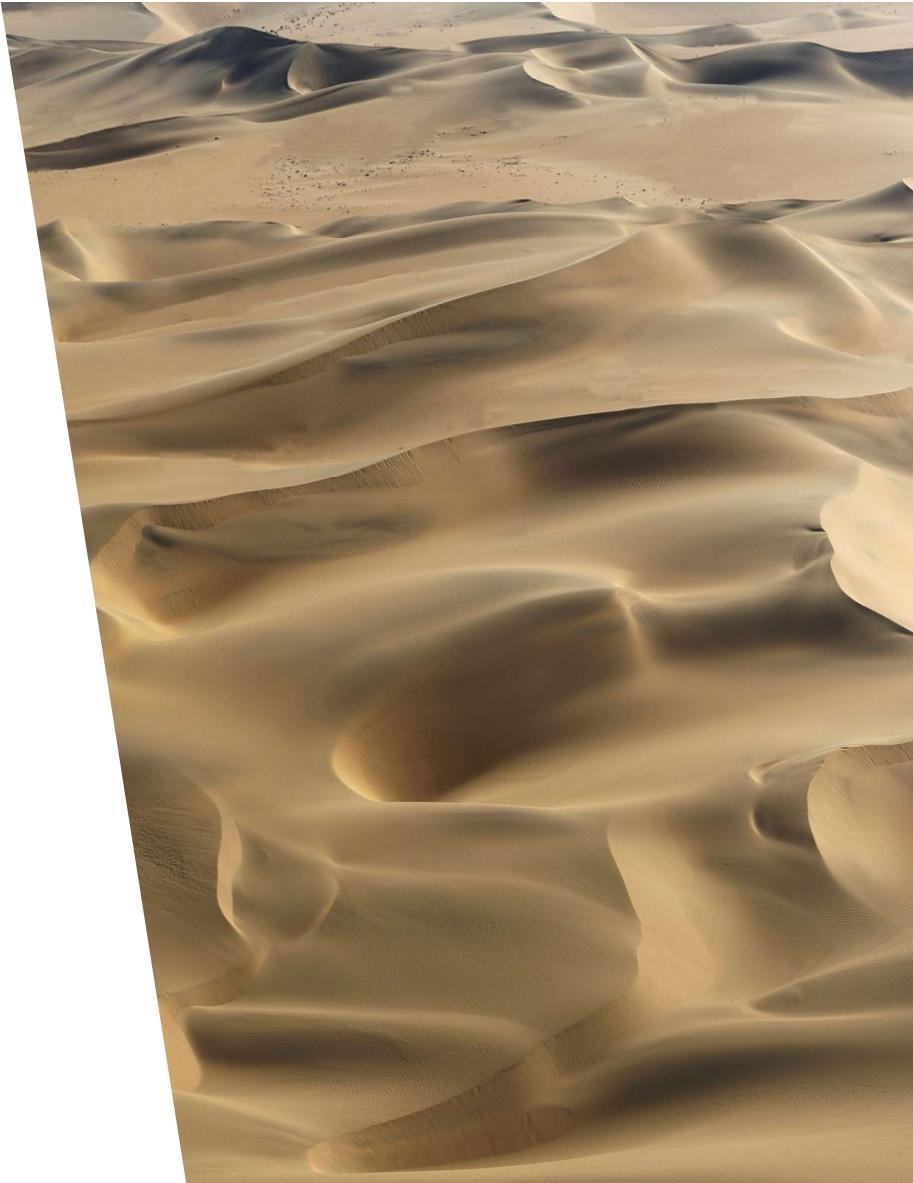
US OUTLOOK

Shifting headwinds driven by inflation and war

Kathy Bostjancic, Chief US Economist



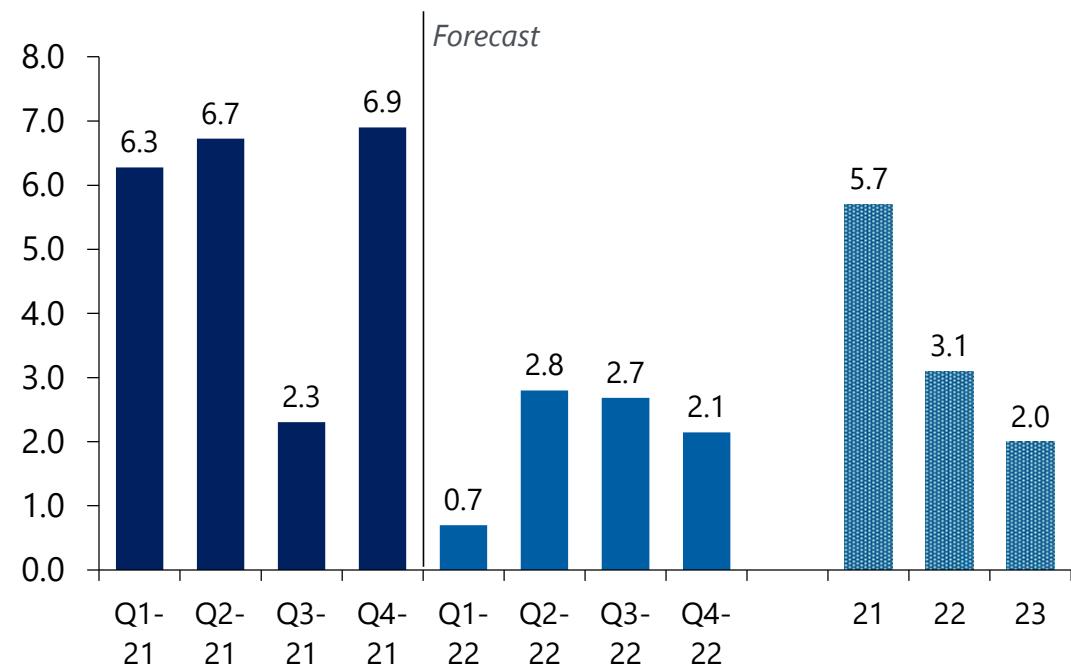
April 2022



Growth will improve in the spring post Omicron

US: GDP Forecast

Real GDP growth, % annualized

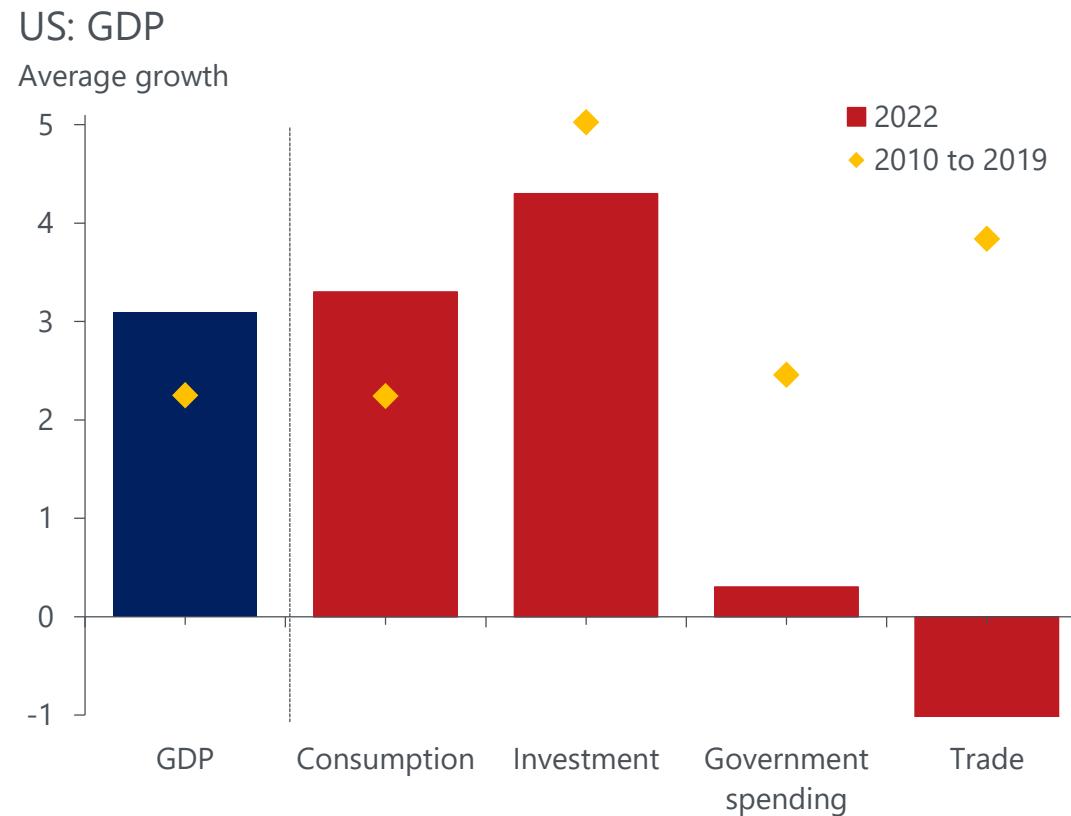


Source: Oxford Economics

The US economy faces shifting headwinds. Higher inflation and greater uncertainty triggered by Russia's invasion of Ukraine are overshadowing current concerns about Covid.

We anticipate real GDP will grow by 3.1% this year and slow to 2.0% in 2023, but risks are tilted to the downside given the intensifying inflation shock, increased supply chain stress, a more hawkish Fed, and a growing fiscal drag.

Resilient consumption will underpin strong growth in 2022

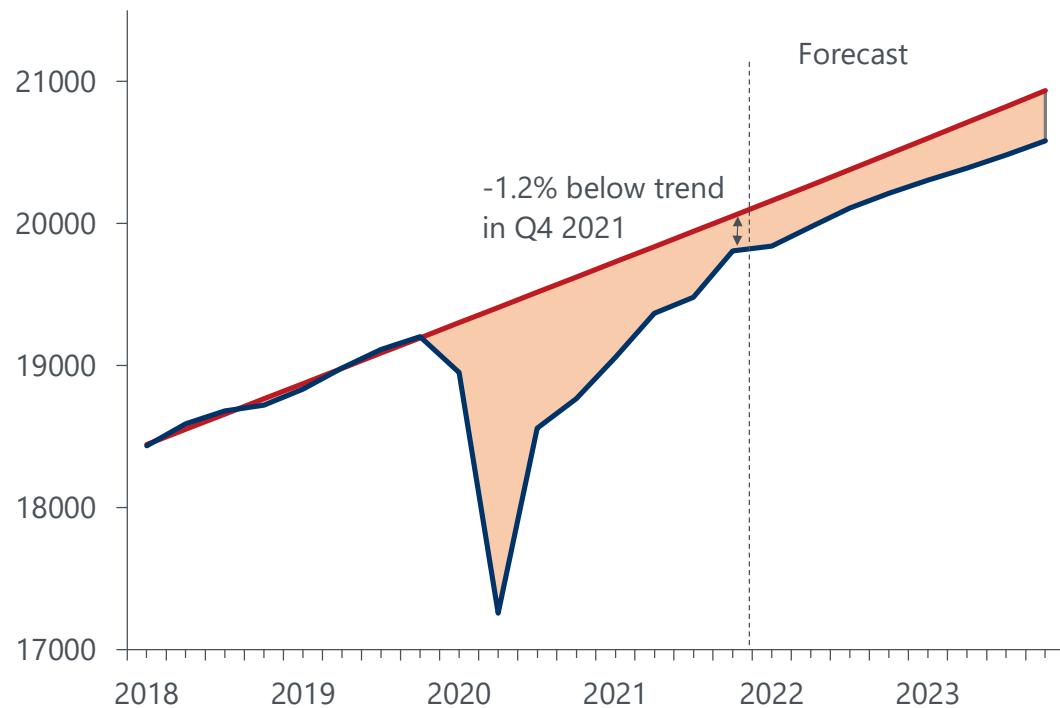


Source: Oxford Economics/Haver Analytics

But the economy will not get back above pre-virus trend

Real GDP: Slower growth means staying below trend in 2022

\$, billions

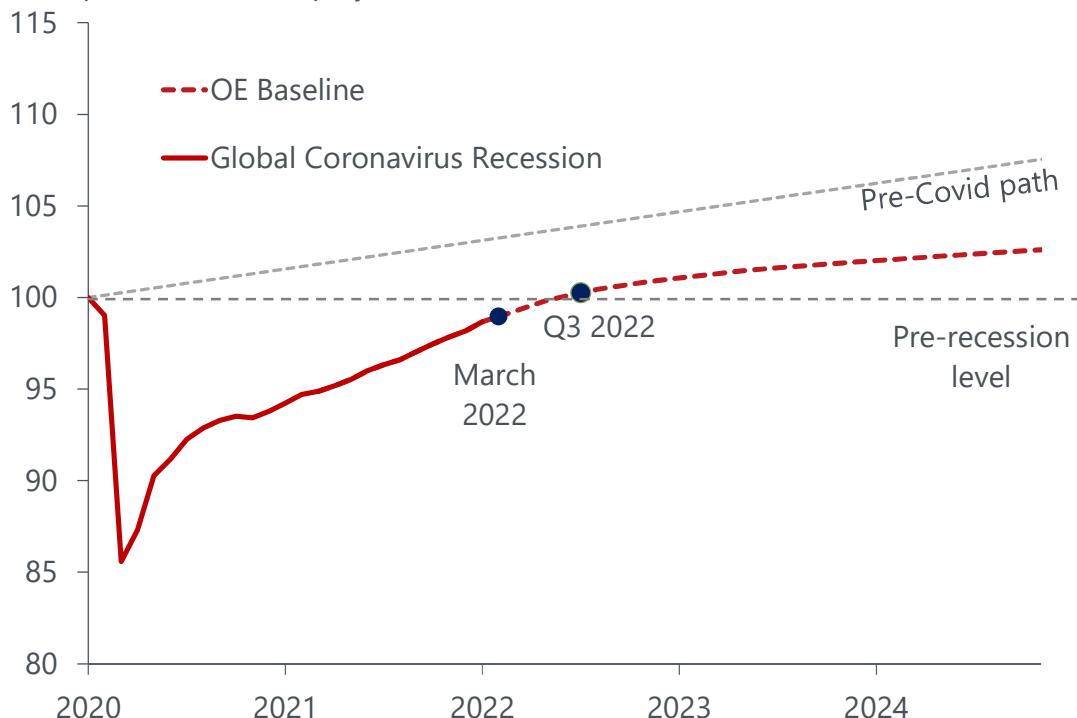


Source: Oxford Economics, BEA

We see a full labor market recovery by Q3 2022

US: Employment recovery paths

Peak pre-recession employment = 100

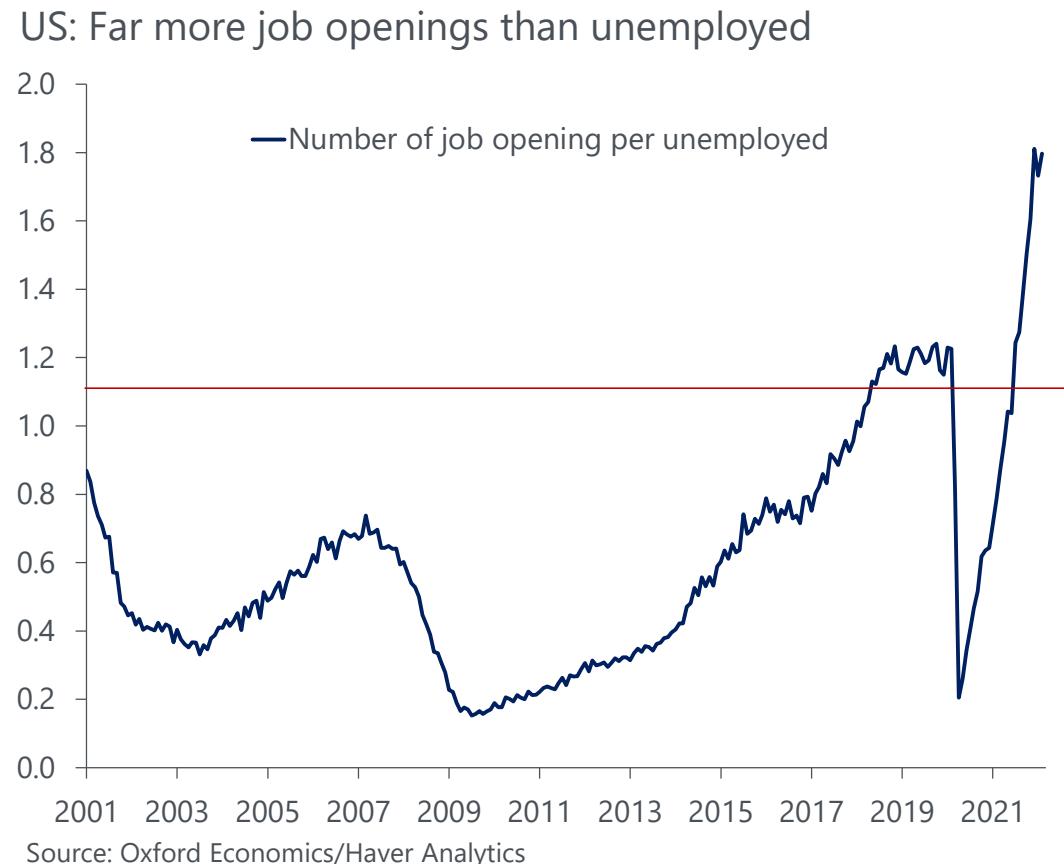


Source: BLS/Oxford Economics/Haver Analytics

The labor market remains hot, with nonfarm payrolls expanding a strong 431k in March after an upwardly revised 750k gain in February. The unemployment rate moved to a cycle low of 3.6% despite the labor force participation rate improving to 62.4% from 62.3%.

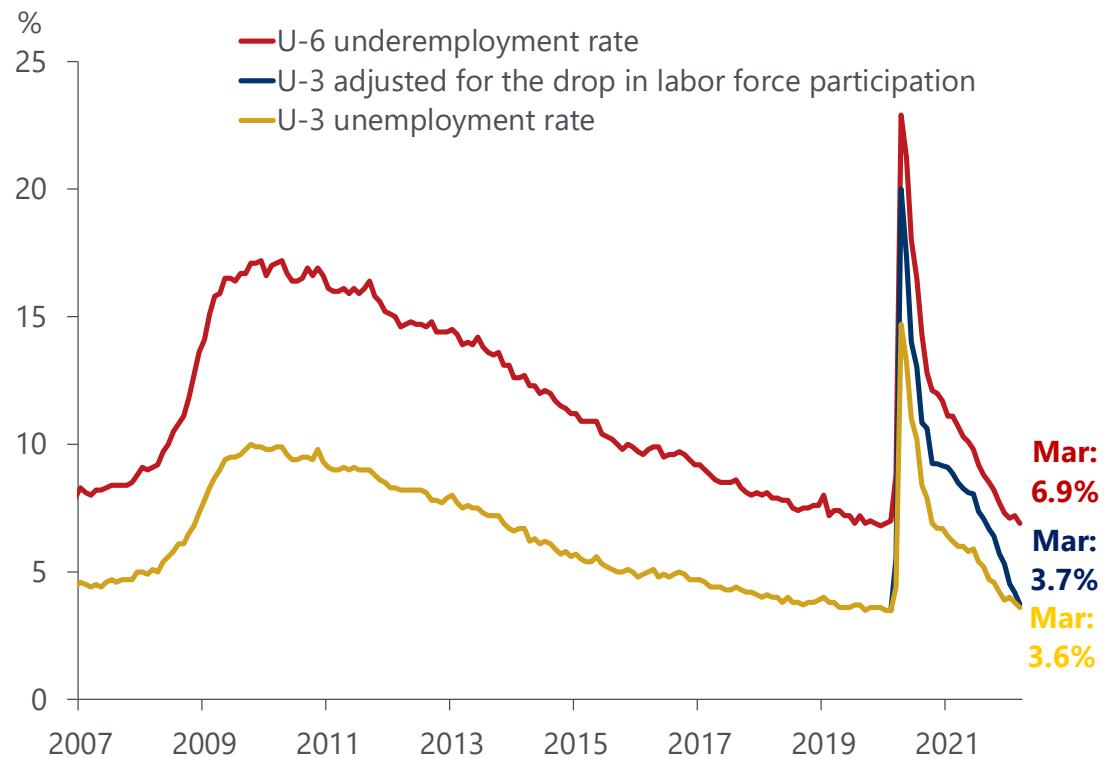
Reflecting the tightness in the labor market, average hourly earnings posted another strong increase of 0.4% that lifted the annual rate up to 5.6% from 5.2% in February. Incomes have been supported by compensation growth this year, after fiscal transfers were the driver in 2022.

Powell says the labor market is “tight to an unhealthy level”



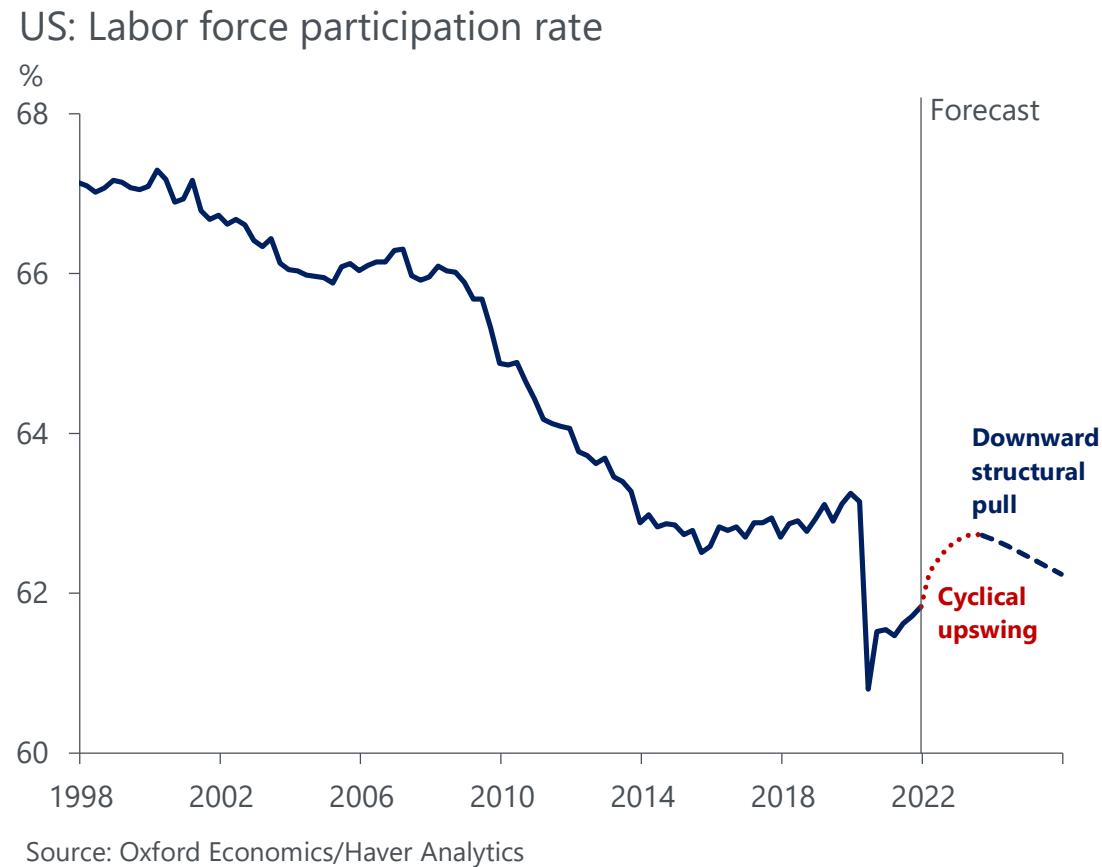
Unemployment rates continue to show strong progress

US: Unemployment rates



Source: Oxford Economics/Haver Analytics

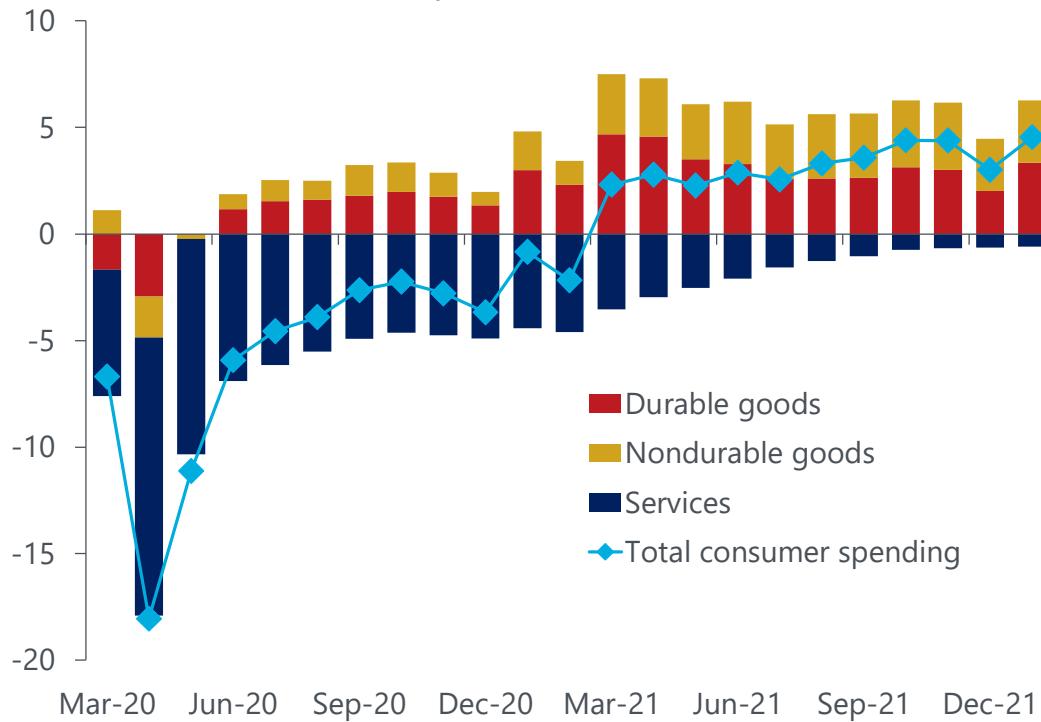
A rebound in labor supply is a hopeful sign for 2022



Services spending is growing; goods demand remains strong

US: Services spending is catching up; robust goods demand

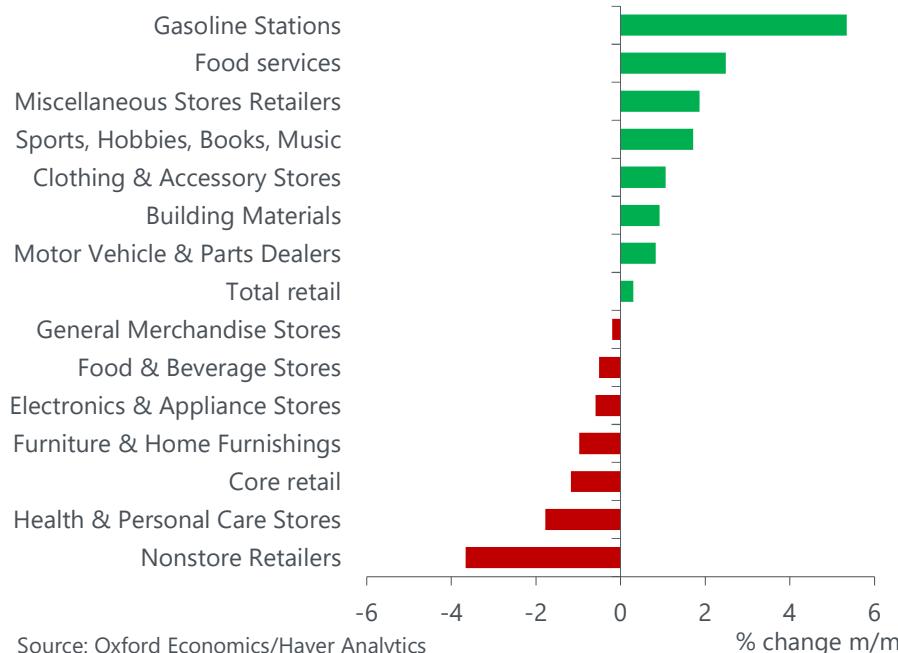
Percent difference from February 2020



Source: Oxford Economics/Haver Analytics

Retail sales were mixed in February; still 25% above pre-Covid levels

US: Mixed retail sales in February



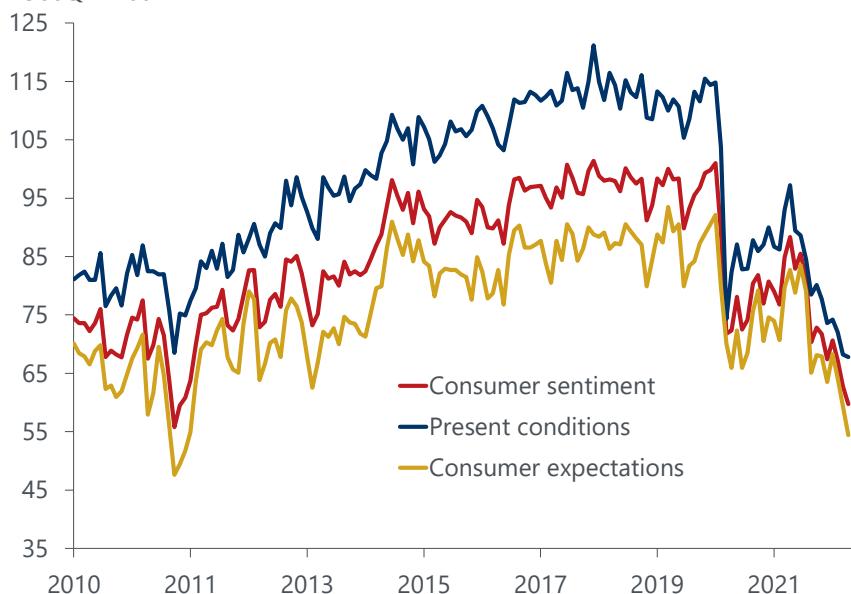
US: Elevated inflation is boosting retail sales



Higher expected inflation is keeping sentiment depressed

US: Consumer sentiment

1966Q1=100



Source: Oxford Economics/Haver Analytics

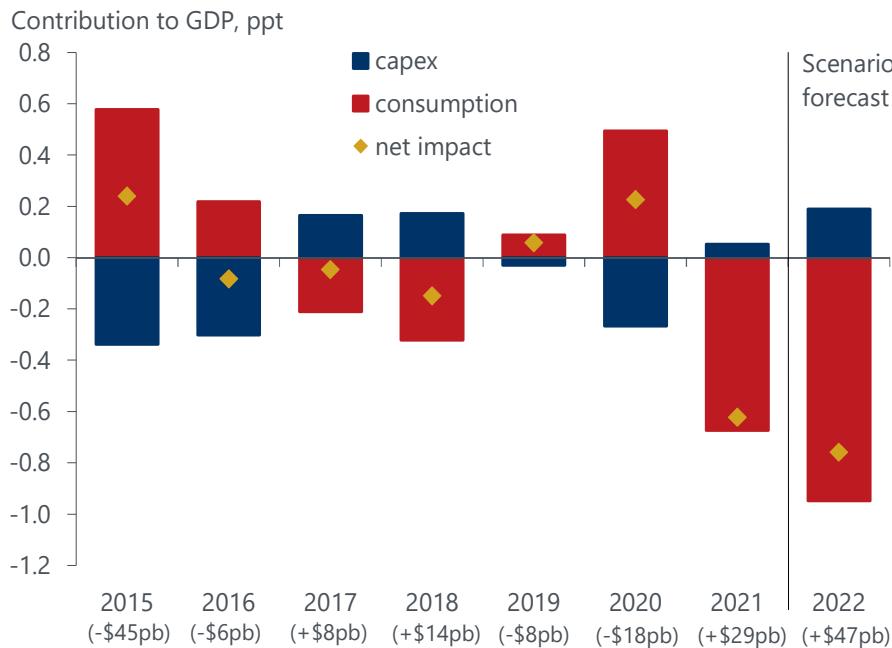
US: Near-term inflation expectations are well above long-run



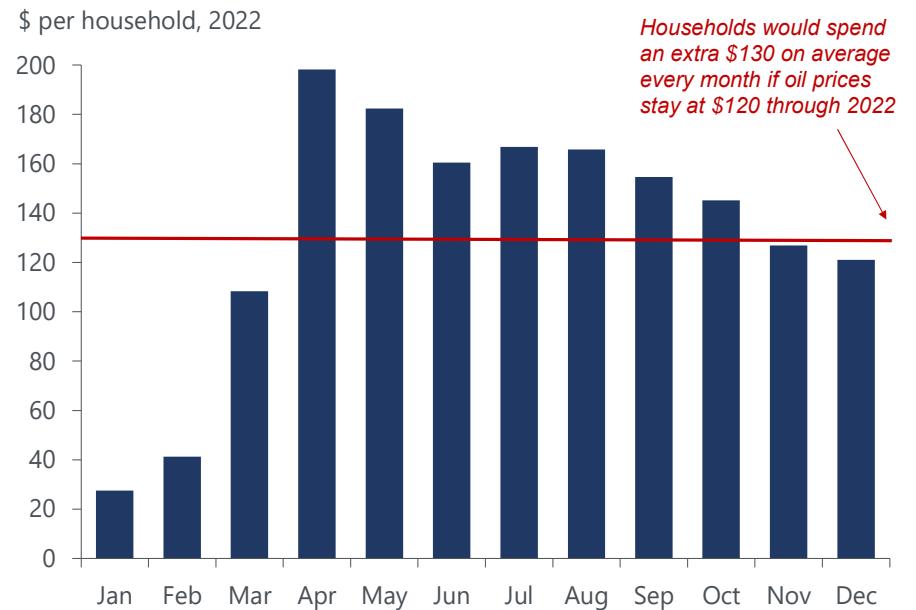
Source: Oxford Economics/Haver Analytics/University of Michigan

While higher oil prices will pose a headwind to consumption

US: Oil price swings



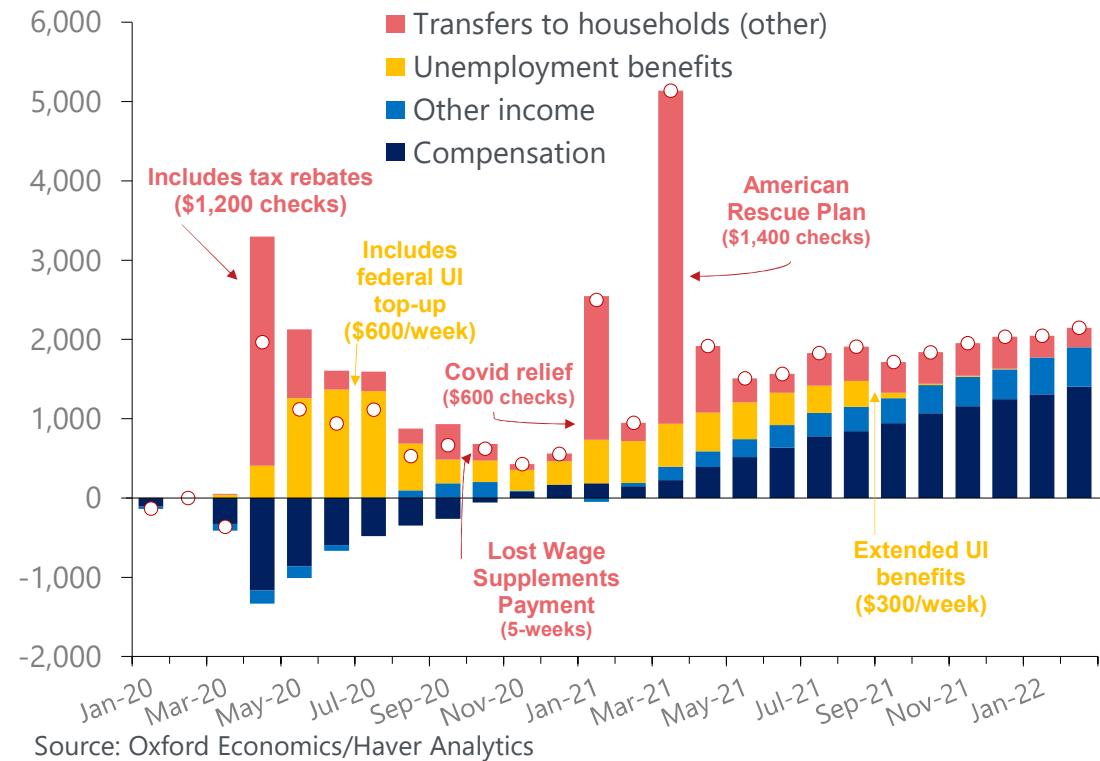
US: Extra cost at the pump from permanent oil price shock



And household incomes are still enjoying a strong cushion

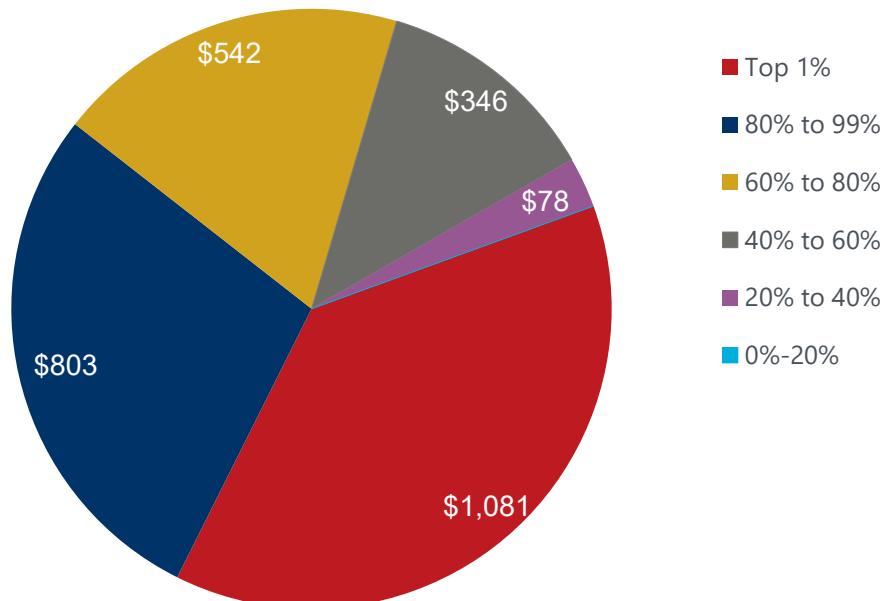
US: Understanding the personal income dynamics

Total personal income, change relative to February, \$bn



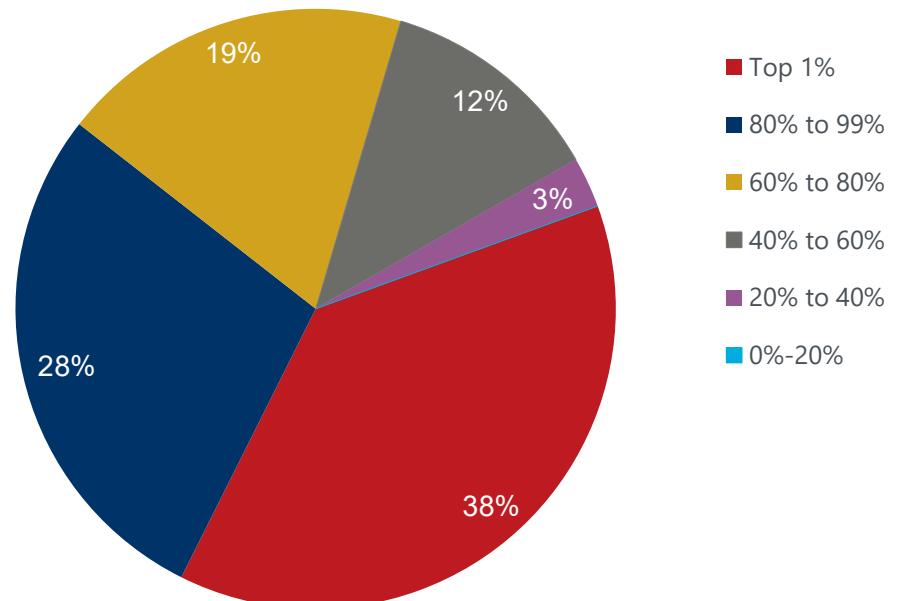
How consumers spend their excess savings remains a key question

US: Excess liquid savings accumulated by income, in blns



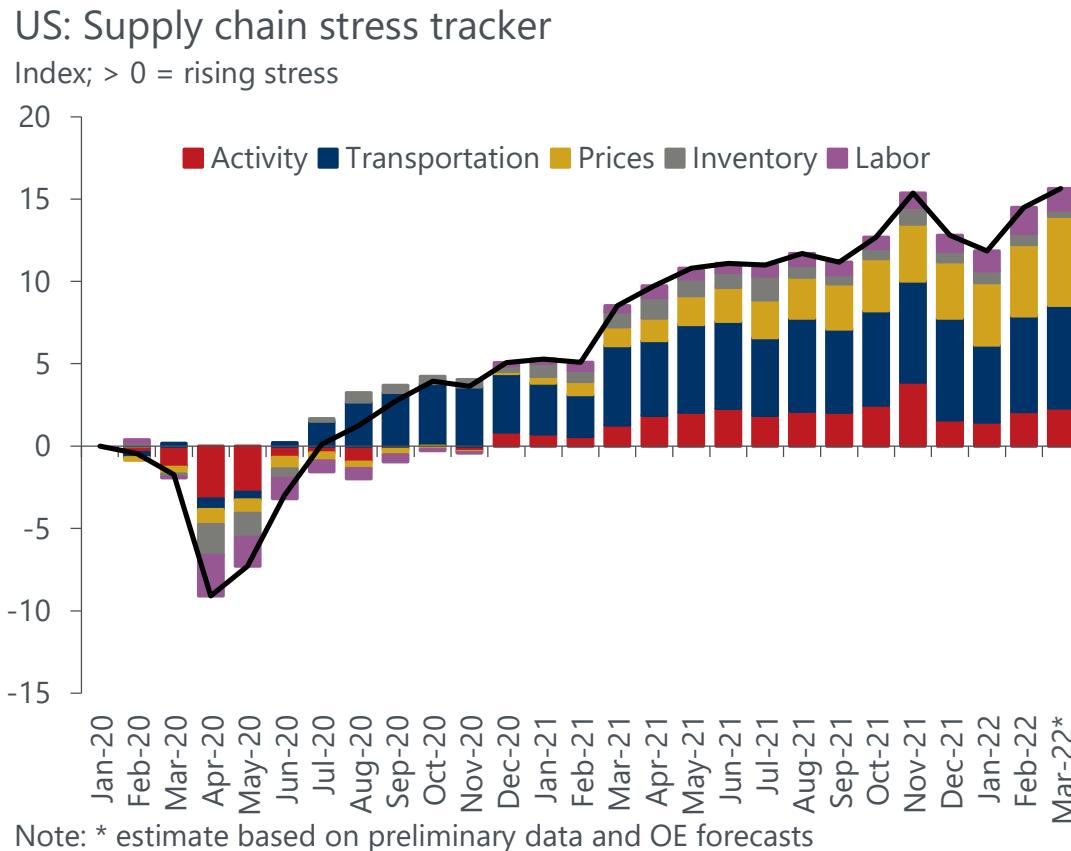
Source: Oxford Economics/Haver Analytics

US: Distribution of excess liquid savings by income

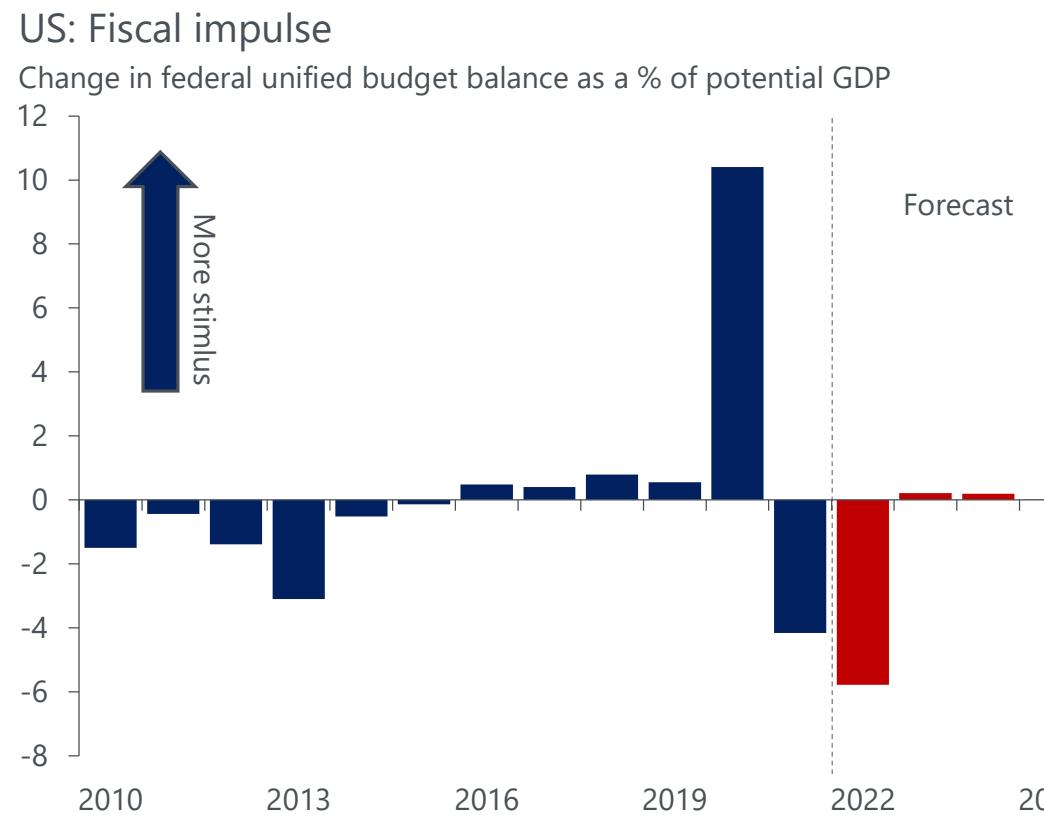


Source: Oxford Economics/Haver Analytics

Supply chains are distressed further by Russia-Ukraine war

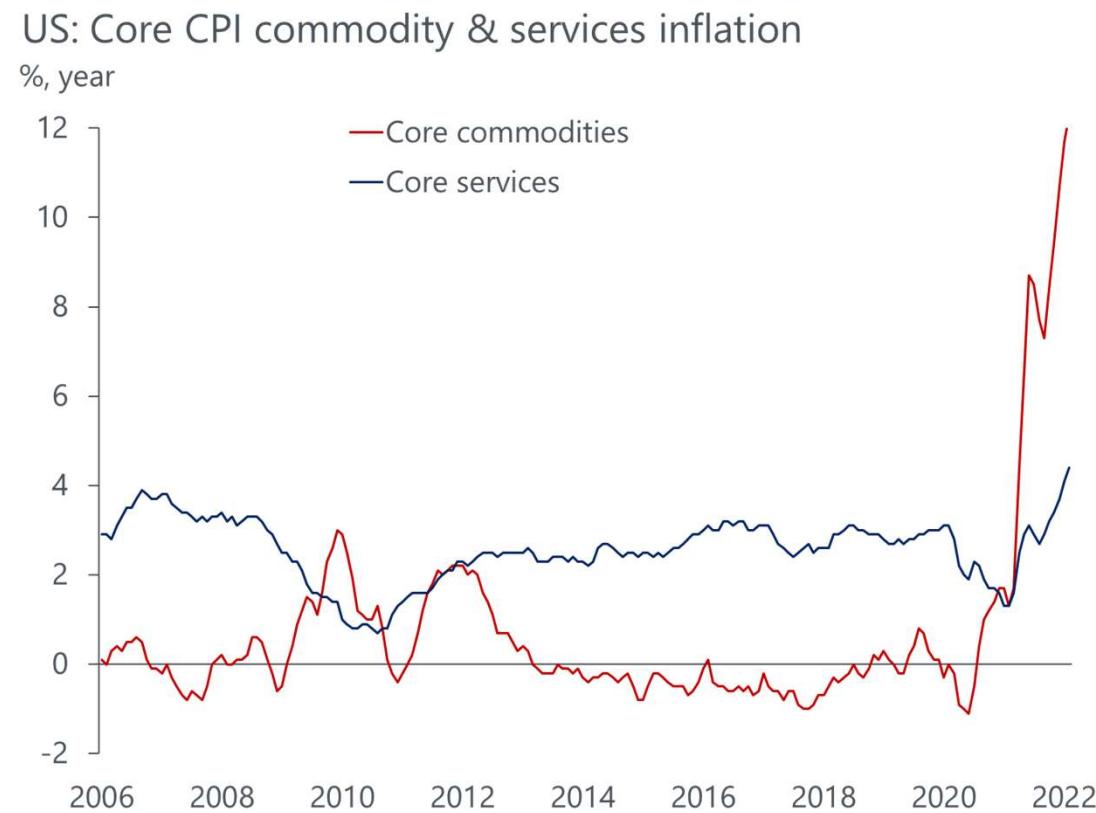


The fiscal impulse turns more negative in 2022



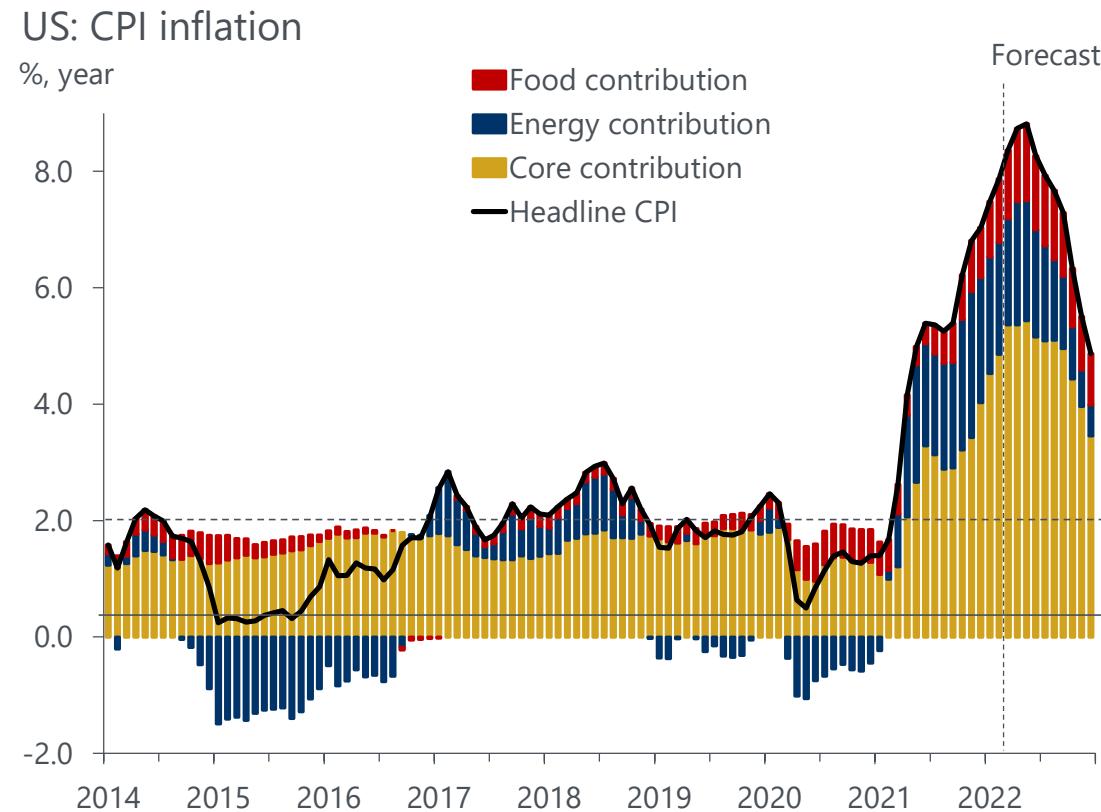
Source: Oxford Economics/Haver Analytics

Core goods prices continue to soar, while core services heating up too



Source: Oxford Economics/Haver Analytics

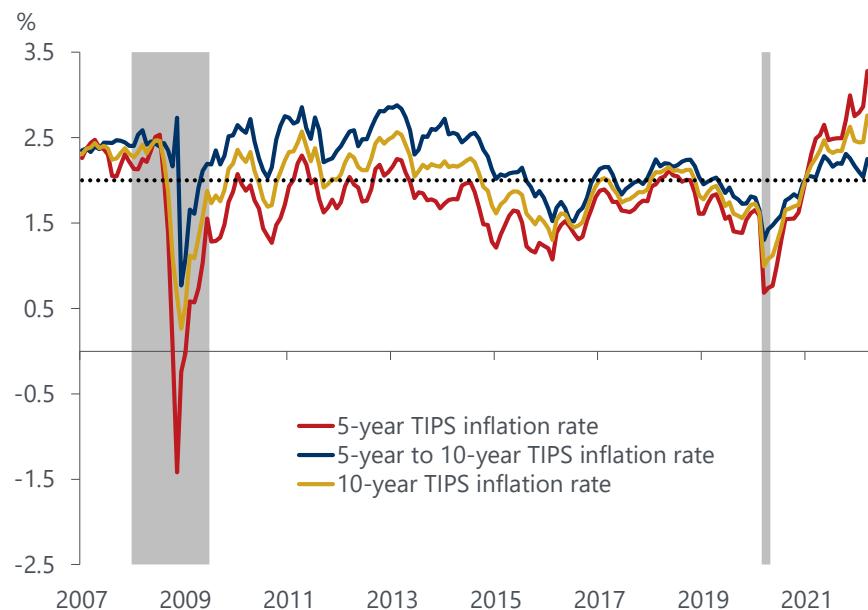
Higher food and energy prices will keep inflation above 4% by Q4



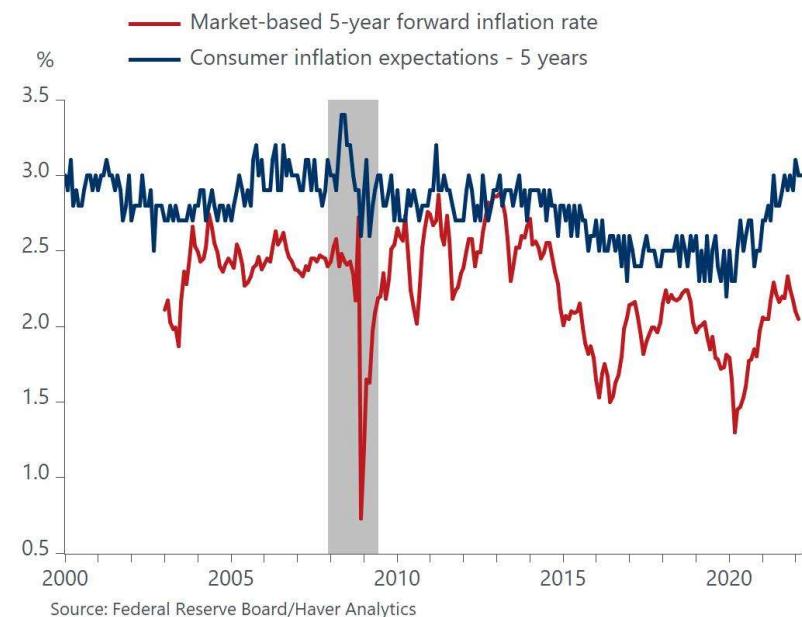
Source: Oxford Economics

Long-term inflation expectations still remain anchored

US: TIPS inflation breakeven rates



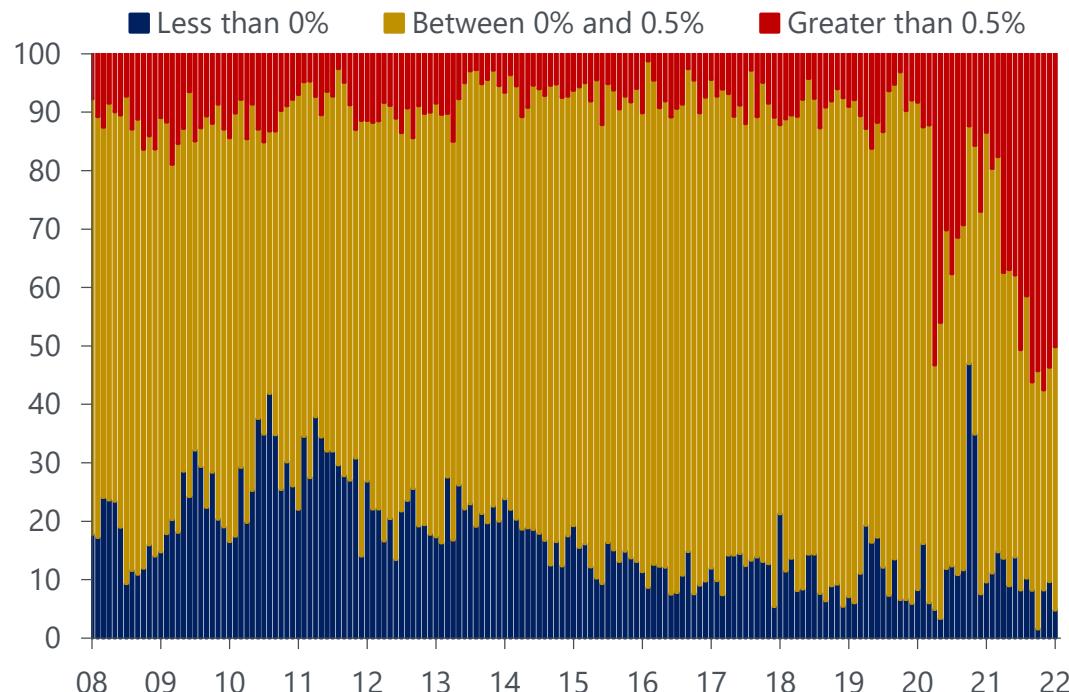
US: Inflation expectations



Wage growth is continuing to broaden in early 2022

US: Distribution of employment by wage growth

Share of jobs seeing a 6-month average monthly wage gain of:

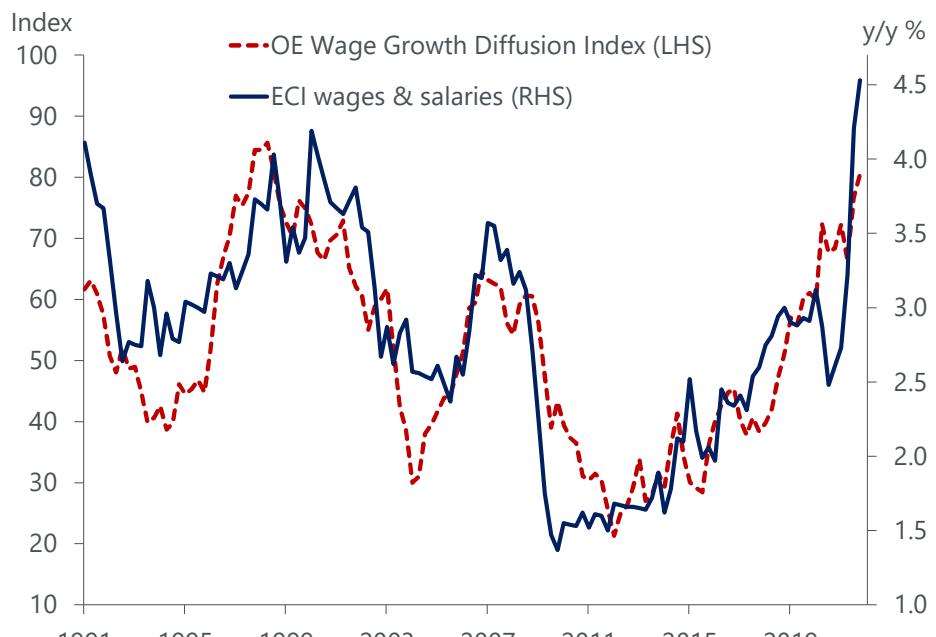


Note: Calculation based on sub-industry average hourly earnings data

Source: Oxford Economics/Haver Analytics

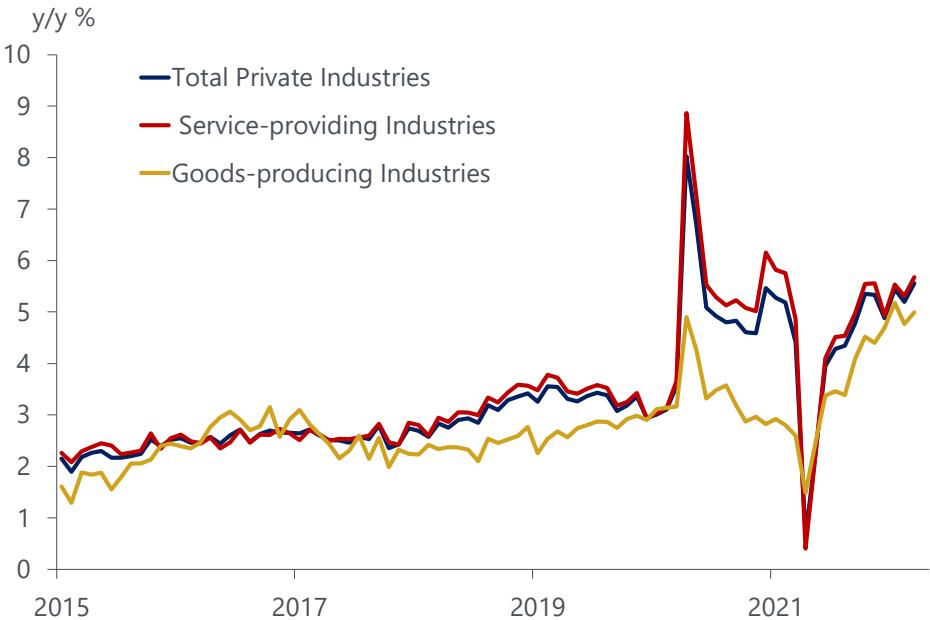
Wage pressures rising, but should cool as participation rebounds

US: Wage Growth Diffusion Index



Source: Oxford Economics/Haver Analytics

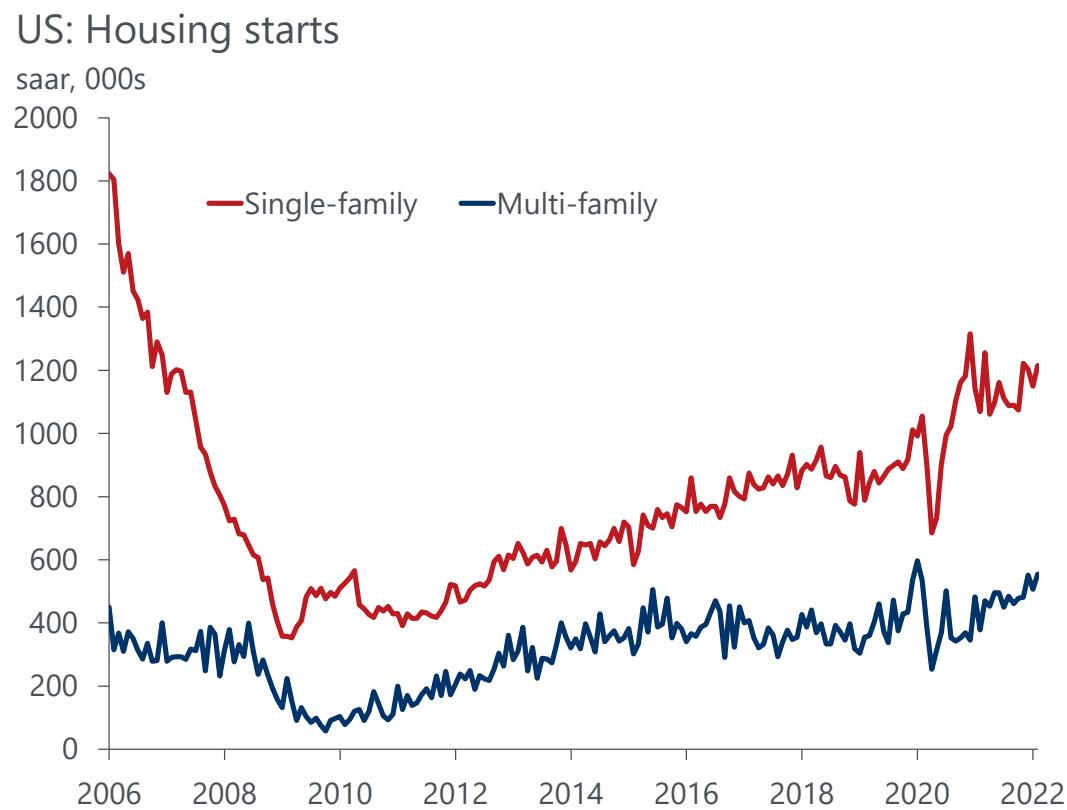
US: Total private average hourly earnings



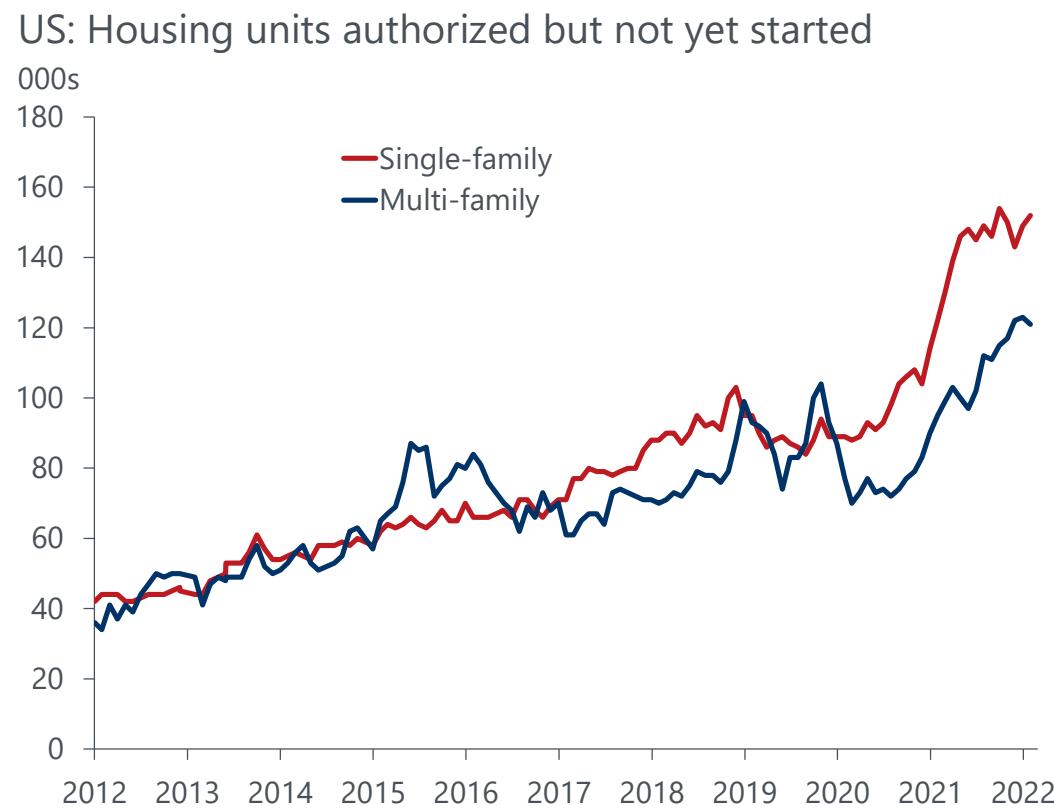
Source: Oxford Economics/Haver Analytics

Note: Data from Jan 1985 to Feb 2007 inferred from production and nonsupervisory

February housing starts rise to their strongest pace since June 2006



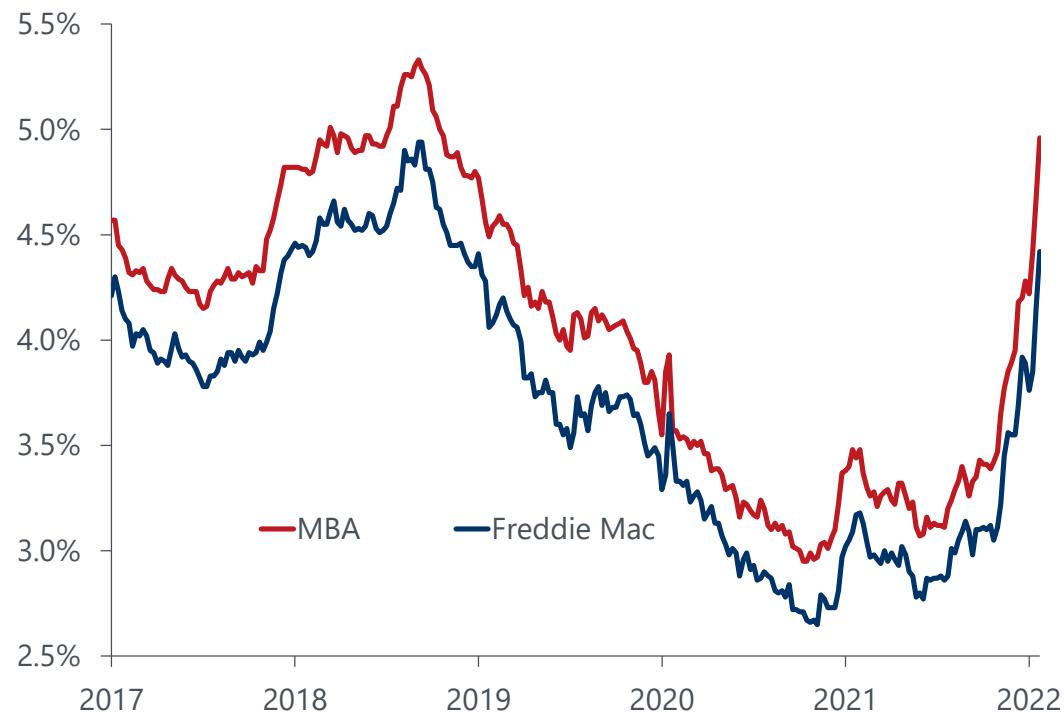
But backlogs of new construction are at a record high



Source: Oxford Economics/Haver Analytics

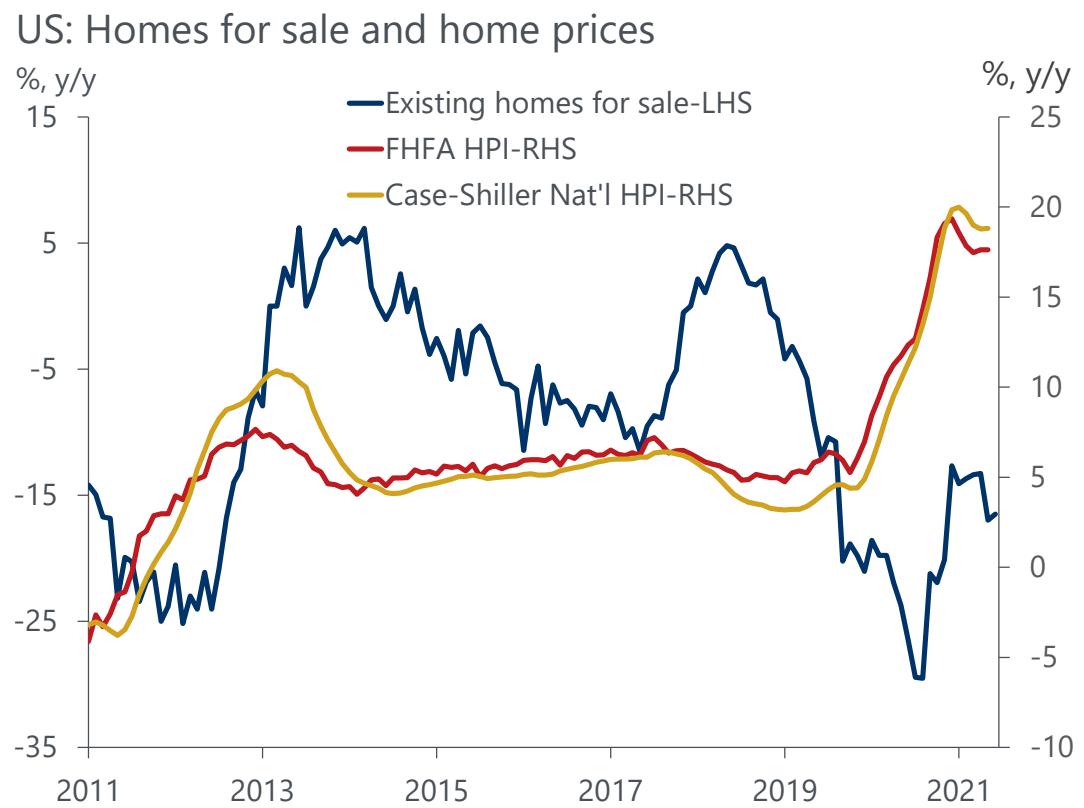
Rising mortgage rates will impose a new headwind to affordability

US: 30-year mortgage rates

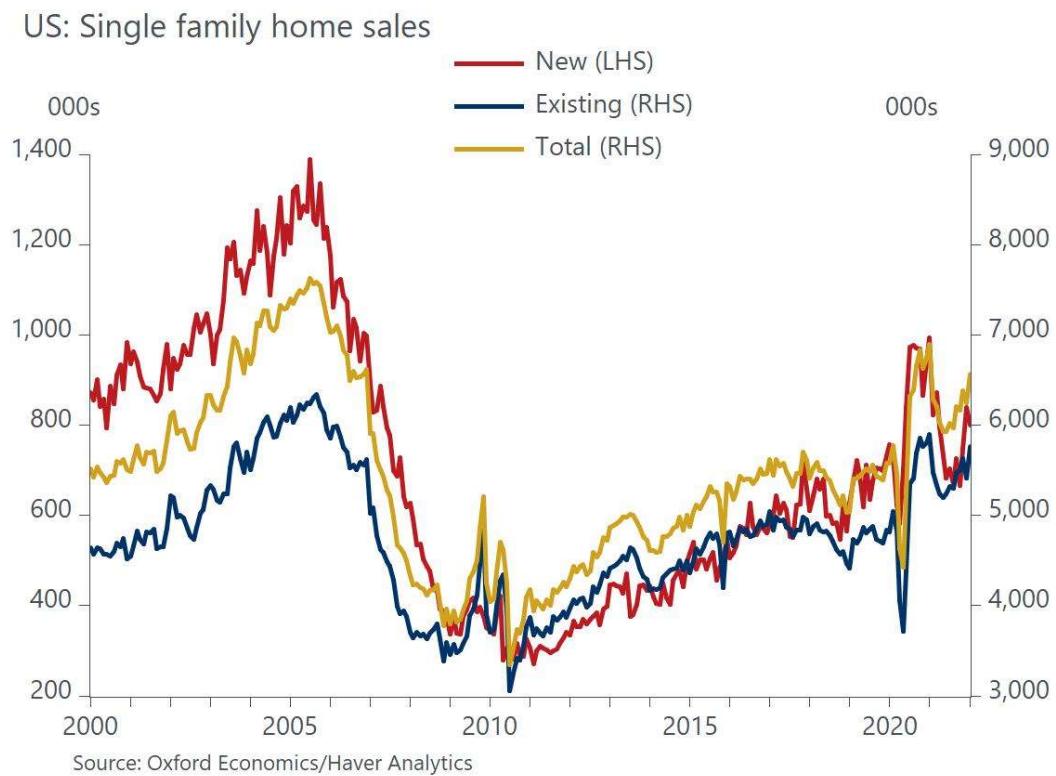


Source: Oxford Economics/Haver Analytics

Home prices continue to show signs of moderation

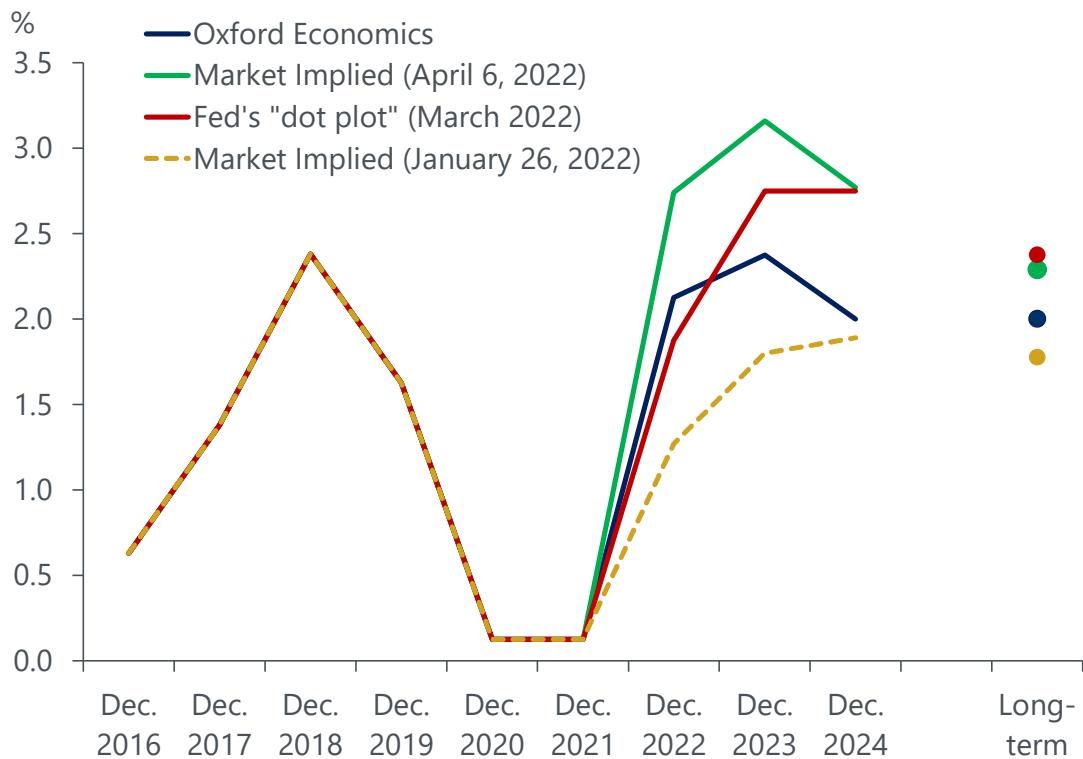


We see home sales losing some momentum in the months ahead



Fed aims to restore price stability

US: Federal funds rate expectations



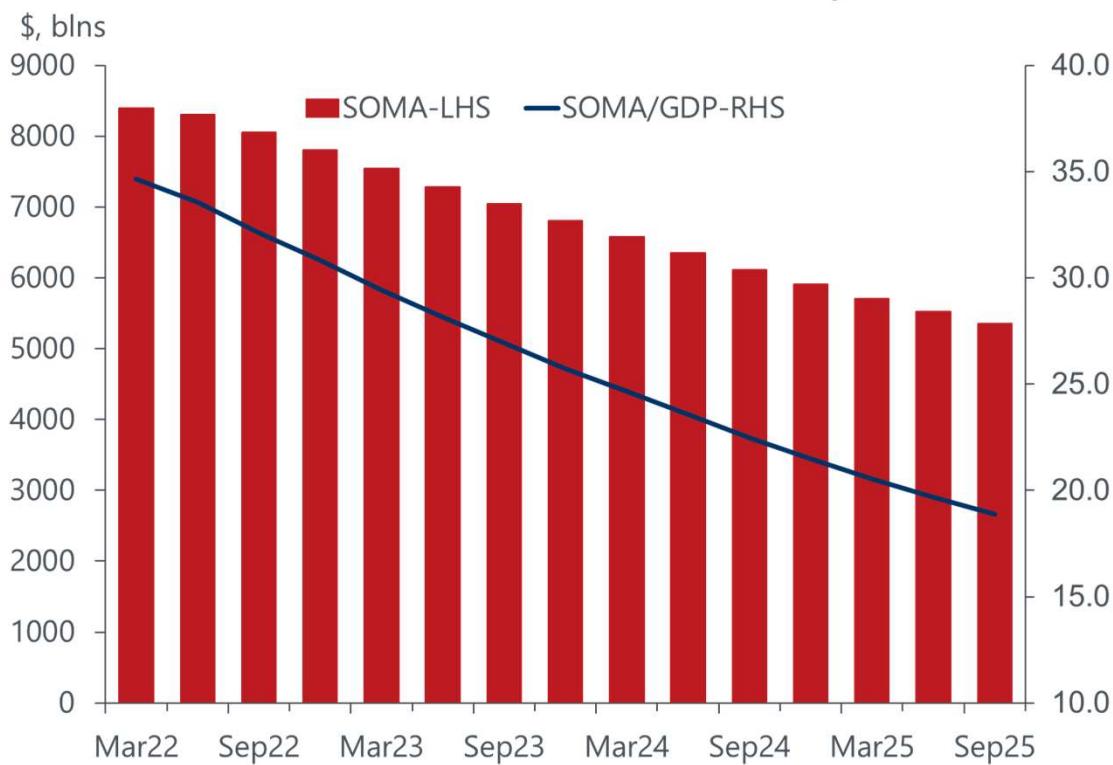
Source: CME/Federal Reserve/Oxford Economics

After kicking off its rate tightening cycle with 25bps in March, forward guidance signals at 50bps rate hike in May, followed by another 50bps in June. We now see the policy rate rising a total of 200 bps this year and moving to a restrictive level of 2.63% by mid-2023, before the Fed cuts the rate 25bps to 2.38% by year-end 2023.

The Fed's median forecast calls for a higher rate of 2.75% - which is above the downwardly revised long-run neutral rate of 2.4% (previously was 2.5%).

Balance sheet run-off will start mid-year, but could be as early as May

US: The Fed can normalize the SOMA in three years



Source: Oxford Economics/Haver Analytics

We expect the pace of reduction to quickly ramp up to \$90bn/month resulting in a reduction of \$400bn this year and \$1tn in 2023. This should be equal to about 1.5 to 2.5 (25bps) rate hikes.

Financial conditions remain accommodative as curve flattens

US: Financial conditions

0 = Average stress



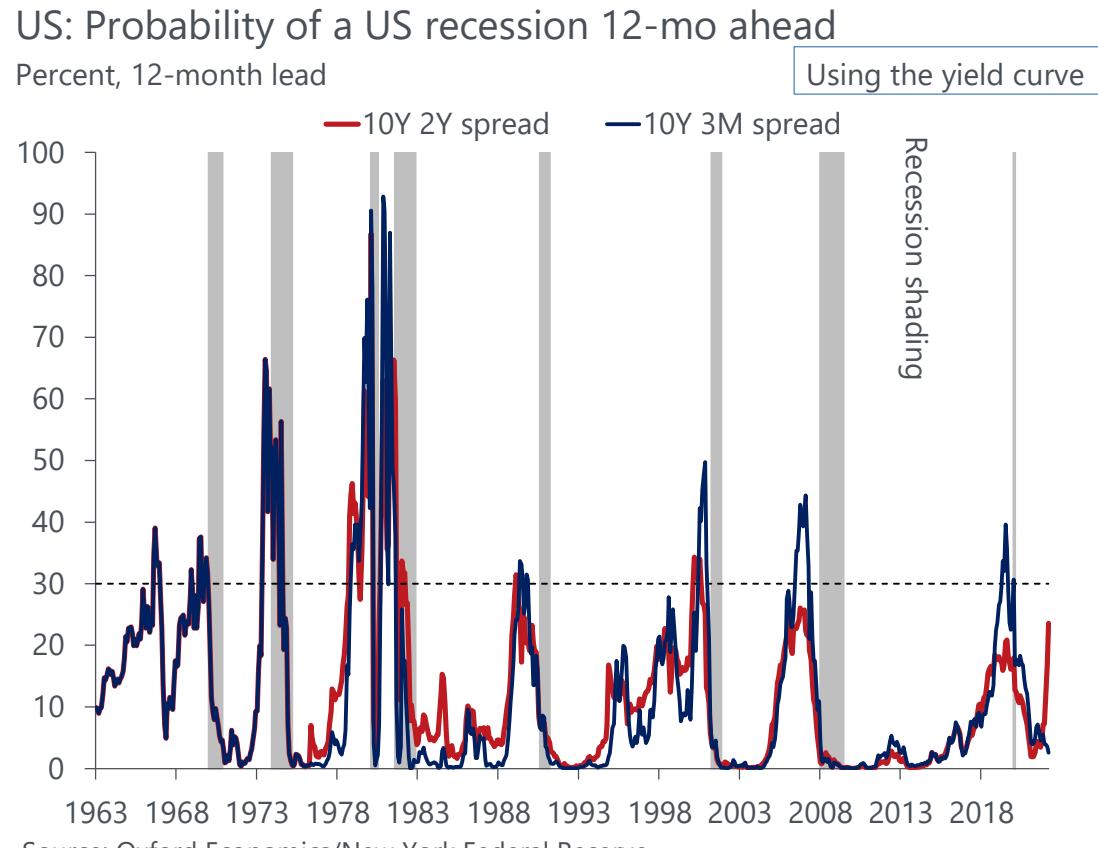
Source: Oxford Economics

US: Yield curve steepening



Source: Oxford Economics/Haver Analytics

Recession odds rising using 10 - 2 year spread



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