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Key Themes in the U.S. Economic Outlook

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Disclaimer

The views I will express today are my own and do not necessarily reflect the positions of the Federal Reserve Bank of St. Louis or the Federal Reserve System.

The Big Picture

- The economy has taken several body blows the past several years. Economists call these “shocks.”
- Real GDP growth was very strong (5.7%) in 2021 but not sustainable given the economy’s fundamentals.
- The slow return to “trend” growth was interrupted by another set of shocks (e.g., Omicron and Russia).
- Real GDP growth has averaged 0.1% thus far in 2022. Two negative quarters but no recession. Unusual!

Themes in the Economic Outlook

- An inflation surprise in 2021—the dreaded “T” word!
- By January 2022 (before the Russian invasion), CPI inflation had risen to 7.5%. It briefly touched 9% in June, but it has since slowed modestly.
- Core inflation has not slowed. The challenge for the Fed (and other major central banks) is reigning in inflation without causing a recession.
- It’s a high-wire act fraught with huge challenges.

Key Themes in the Outlook

Key Themes in the Outlook

1. Inflation is too high and miles above the 2% target.
 - Headline inflation is about 8%; core is about 7% (YOY).
2. GDP growth in Q3 received a big boost from net exp.
 - The consensus forecast for Q4 is 0.2% and negative for the first half of 2023.
3. But labor market conditions remain strong, and consumers are still spending; using debt and saving.
 - The fundamentals point to slower employment gains.

Key Themes in the Outlook

4. Real (inflation-adjusted) household wealth is falling.
5. Housing construction and house prices are both turning downward.
 - Rising mortgage rates and reduced affordability.
6. Manufacturing activity is still increasing.
7. The Fed is committed to “keeping at it.”
8. Weak labor productivity growth is concerning; bodes ill for long-term prosperity.

Key Themes in the Outlook

8. The global economy is weakening—particularly for Europe and China. Dollar is at an all-time high.
9. Geopolitical risks seem unusually high.
10. In sum: The path to a soft landing is fraught with crosscurrents, faulty gauges, a short runway, and an aircraft near its stall speed with little fuel.
11. C'mon, man, give us some good news!
 - We dodged a bullet!



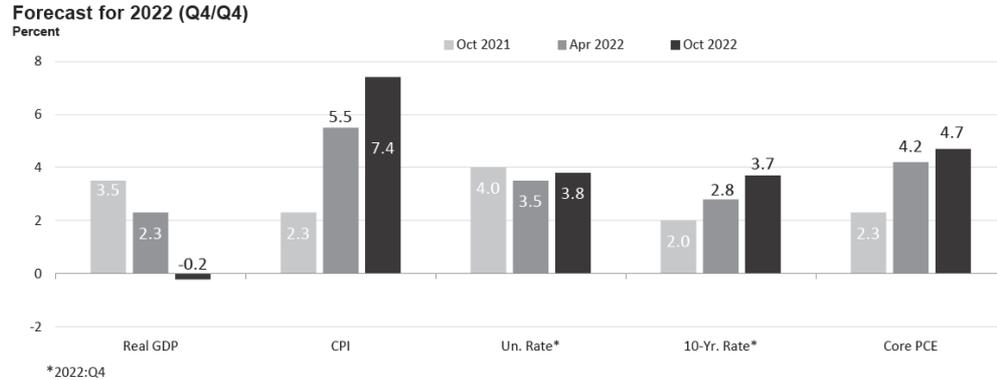
If the Philadelphia Phillies Win the World Series, Prepare for an Economic Crisis

It happens every time a team from the city succeeds

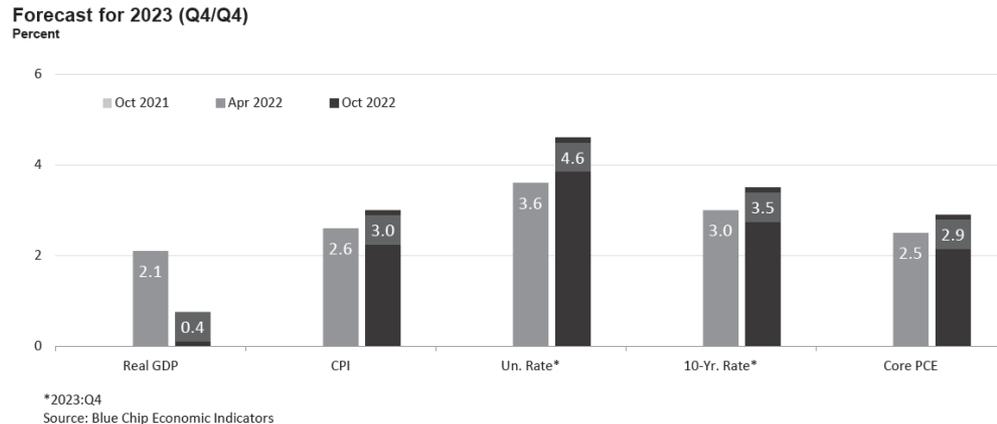
The Wall Street Journal, October 27, 2022

The Consensus Forecasts for 2022-23

2022



2023



Conclusions

- Key economic data have given conflicting signals.
 - Good: labor markets, consumer spending on services, and rising manufacturing activity.
 - Bad: Housing, spending on durables, productivity.
- Financial markets are pricing in a recession or continued slow growth (e.g., yield curve inversion).
- The Fed is committed to restoring price stability; it's not clear how high the policy rate will need to go.

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QUESTIONS?