April 2022
Economic Overview

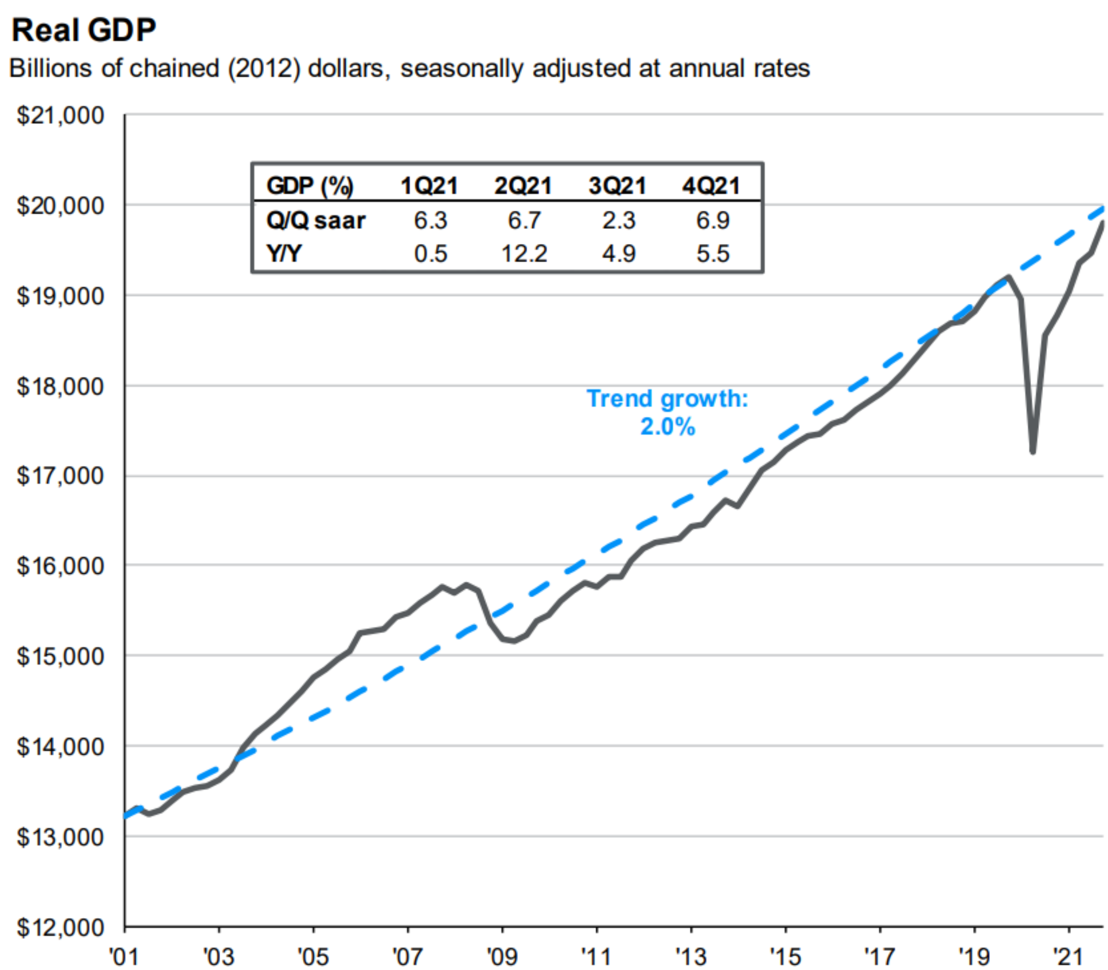
First Affirmative
FINANCIAL NETWORK
Invest for a Sustainable Future

Overview: High Inflation, Economic Slowdown, and Dissatisfied Workers

By Richard Frankel

As shown in the figure 1 chart below, US GDP is steadily returning to pre-COVID levels. Many industries are recovering from the impact of COVID, which shows that we are "coming back" from COVID-related dislocations – to some degree. There are, however, other economic factors that are going awry in the US which will be discussed in detail in this commentary.

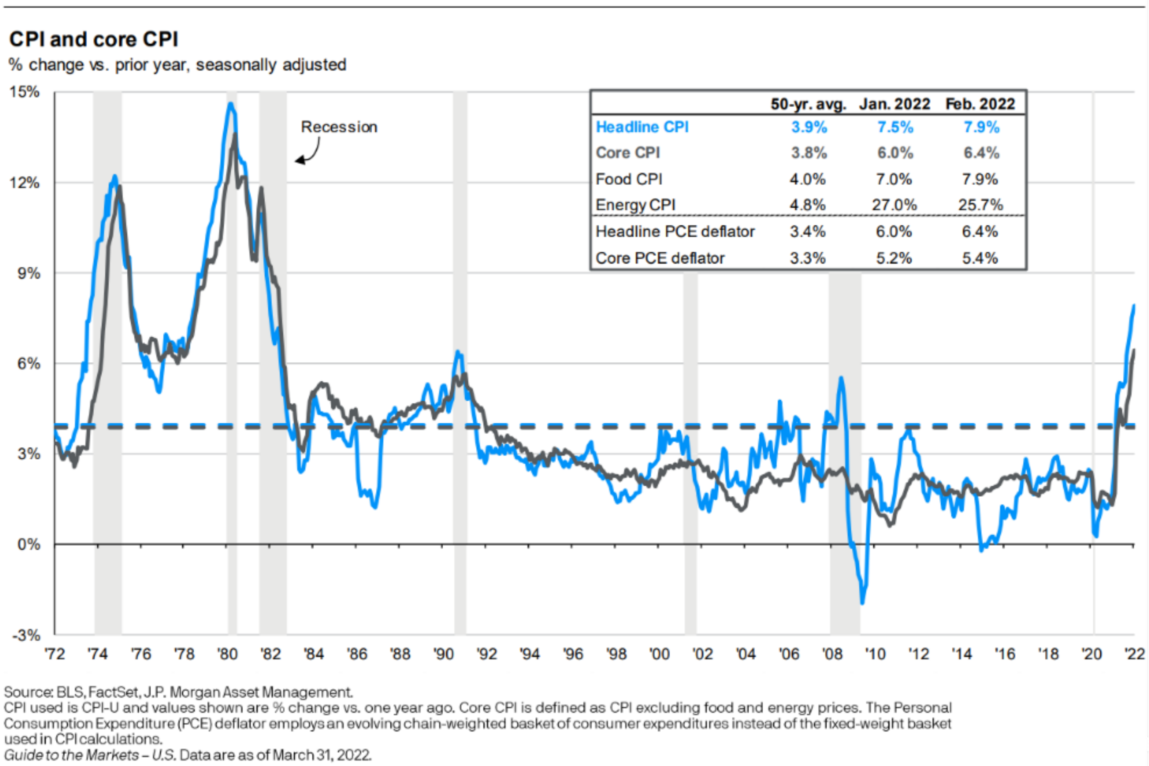
Figure 1. Real US GDP



Source: JPM Guide to Markets 2Q2022

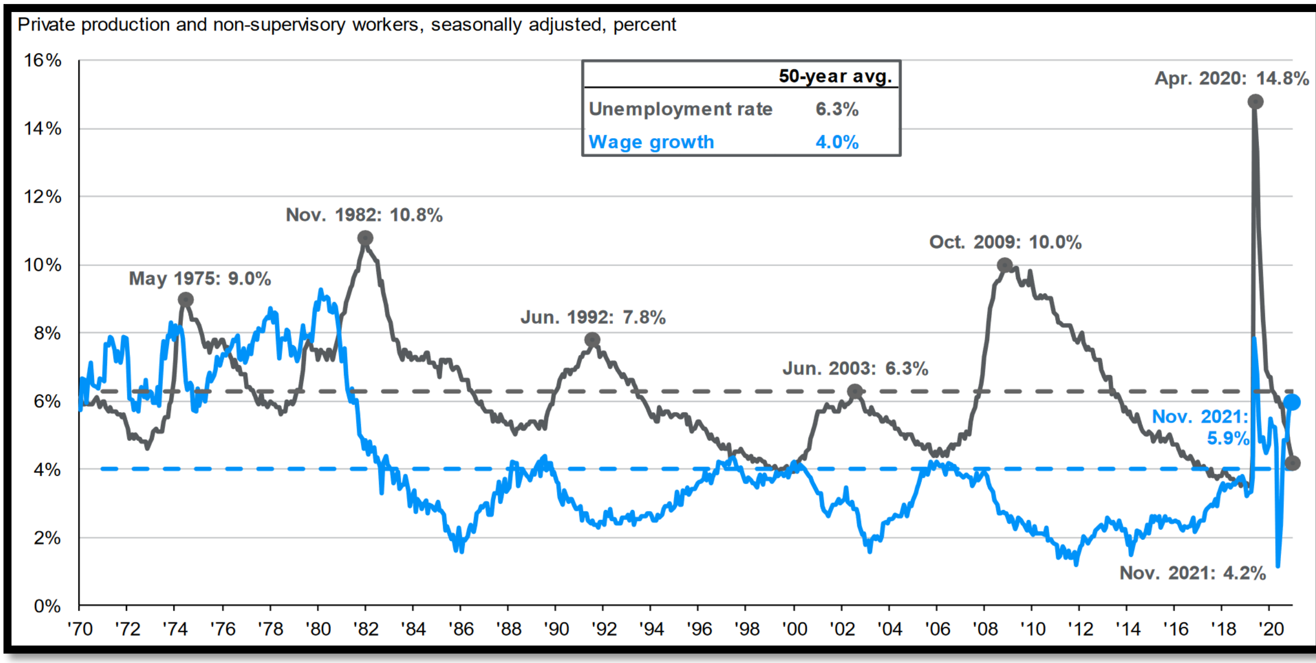
All inflation indicators are currently higher than they have been since the 1982 recession and continue to rise rapidly as seen in the figure 2 chart below. This could be an indicator of times to come. If the Fed raises interest rates to combat our high inflation, then we do run the risk of being thrown into recession.

Figure 2. CPI and core CPI



As shown in the figure 3 chart below, today's nominal yield is 2.32%, which is well-below the 5.81% average since 1958. Real yields are shockingly 6.26% below the average of the past 60-plus years, and at a low not seen since 1975-76 and 1982. Inflation is nearly double its average since 1958, a full 2.78% higher than the average.

Figure 3. Real and Nominal yields



None of these metrics are good and it is likely that the Federal Reserve will enact aggressive policies in an attempt to combat the major gap between real and nominal yields.

Inflation rates are at a level that could precipitate a significant rise in interest rates, which could lead to recession. Surging prices spurred global and domestic supply chain issues, surging demand for goods, high production costs, and massive infusions of government relief funds all have a role in the current inflation issue we were experiencing as we entered 2022 (nbcnews.com/business/business-news/whats-causing-inflation-economists-point-fingers-different-culprits-rcna16156). This has been exacerbated by surging fossil fuel, agricultural commodity, and metals prices in the wake of Russia's war in Ukraine.

In fact, "the last time inflation was this high, the Federal Reserve raised rates so much that it put the U.S. into a recession" ("The Fed Could Sink the U.S. Into a Recession to Tame Inflation" Wall Street Journal). This leads to the questions of, "what happens when COVID-related assistance stops?" and "what happens if the Fed pushes us into a recession to combat inflation?". Without the blanket of aid from the government, people will not be able to spend as much, and only time will tell if the other questions' feared answers come to pass. Essentially, without the government aid blanket, our economy will be laid bare, with high and rising inflation, low domestic worker satisfaction, and war looming overseas. There are many concerns regarding prices of goods and whether they can be afforded by consumers.

Prospects for an Economic Slowdown

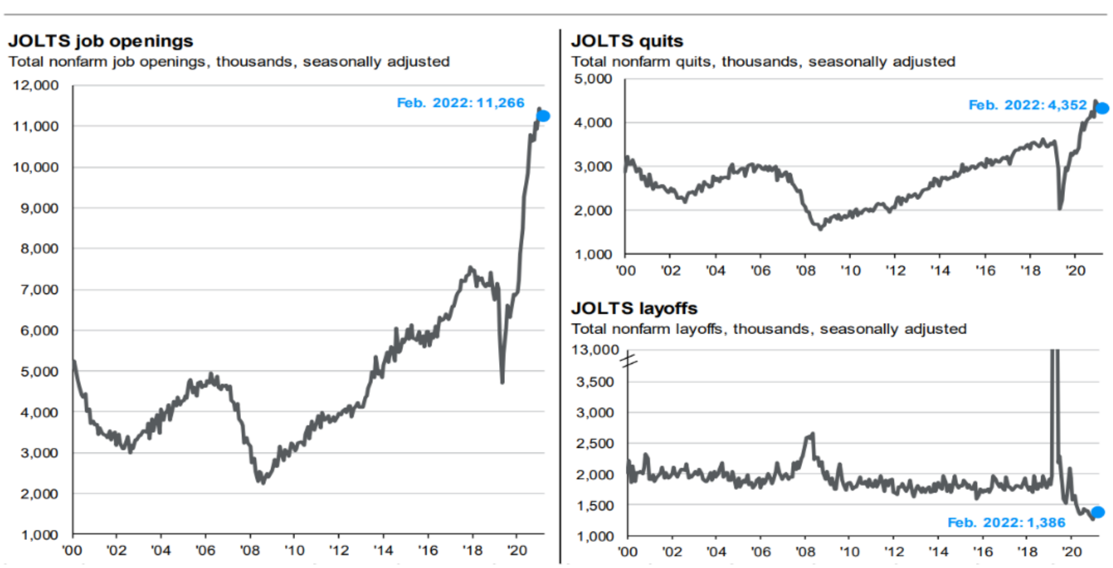
At this point in time, the question is not if the economy will slow, but when and how fast. Once government boons from the pandemic fully disappear, the underlying economy will be shown, its fundamentals laid bare. This is where the worry of economic slowdown comes into play, alongside rising interest rates and war in Ukraine. The underlying economy will not be able to keep up with the many issues that have been occurring over the past few years along with everything done by governments to combat it, especially in the current world's circumstances. The pandemic created a space where governments did their best to hold everything together economically, and now with that aid, and the pandemic, fading away we will see an economic slowdown.

To expand on their earlier mention, rising interest rates, alongside the war between Russia and Ukraine, could cause crippling issues in some areas of the economy. Russia is a major supplier of fossil fuels, agricultural commodities, and metals, and because they just started a war in Ukraine and many are banning their goods, the prices of Russian goods are likely to skyrocket. Supply will be down drastically, resulting in a massive increase in the prices of these goods.

The question of when this slowdown will occur is up for debate, although it is likely to occur slowly "well into the second half of this year and probably beyond." (https://www.forbes.com/sites/miltonezrati/2022/02/07/signs-of-economic-slowdown-have-begun-to-emerge/?sh=4ee505f46249) With inflation so high now, the policies employed to combat it will factor into the timing of the slowdown. Currently, inflation mirrors pre-recession levels, and the Fed will have difficulty balancing the fight against inflation and the desire to maintain positive economic growth.

Labor Demand

Figure 4. JOLTS job openings, quits, and layoffs



Source: U.S. Department of Labor, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of March 31, 2022.

As shown in figure 4 above, current job openings are at a high not seen in the last 20 years. While this is occurring, layoffs are down, so the question is, why are there so many openings? The rate of people quitting their jobs is at a high not seen in the past 20 years as well. This is likely due to job dissatisfaction and low real pay rates in the face of extremely high inflation; people cannot live on the salaries currently being offered to them, and unemployment and other benefits are a more attractive prospect. Unless wages rise at the astronomical rate inflation has set, we are likely to see this trend continue. At present, people need to be paid more to meet their basic needs.

Main Risks:

- Inflation rates continue to rise, causing decreased buying power.
- Interest rates will rise, possibly sharply, to combat inflation.
- As inflation and interest rates rise, so will the number of dissatisfied workers.
    - In the near term, the rate of open jobs will continue to rise with worker dissatisfaction and inflation. Ultimately, job openings will decline as the economy contracts, possibly necessitating a government bailout.

Looking Ahead:

- The Fed could combat inflation with higher interest rates, which could lead to a recession.
- Likely in the second half of the coming year, the economy will begin to slow down.
- We are likely to see more workers quitting their jobs as wages become no longer sufficient to pay for their needs.

First Affirmative FINANCIAL NETWORK

First Affirmative Financial Network

5475 Mark Dabling Boulevard, Suite 108, Colorado Springs, Colorado 80918

719-478-7036 | www.firstaffirmative.com

Registered Investment Advisor (SEC File #801-56587)

Advisor Inquiries

phone: 719-478-7036

businessdevelopment@firstaffirmative.com

Business Development, Marketing, and Media Inquiries

phone: 719-478-7036

businessdevelopment@firstaffirmative.com

Service Inquiries

phone: 719-478-7036

service@firstaffirmative.com