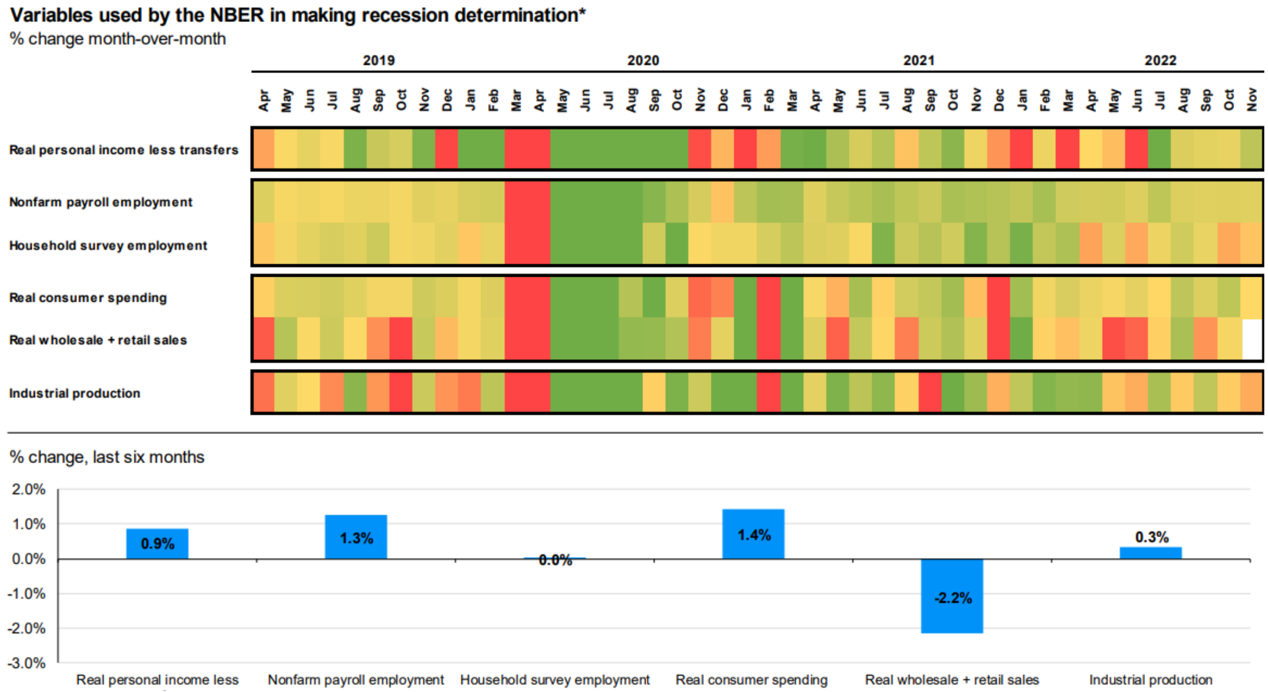
January 2023
Economic Overview

By Richard Frankel

Summary:

- If the US economy slips into recession, it is likely to be shallow (Figure 1). Consensus forecasts point toward an economic slowdown/downturn in 2023, with the beginnings of recovery in 2024 (Figures 7 and 8).
- GDP growth was just below its 2% trend level in 2022 and will fall below that level in 2023, particularly if the US enters a recession (Figure 2).
- Inflation has fallen although it remains well above its 50-year average (Figure 3).
- Housing prices remain extremely high (Figure 4).
- Wage growth is moderating as the unemployment rate levels off (Figure 5).
- Labor demand is down – albeit still high (Figure 6).

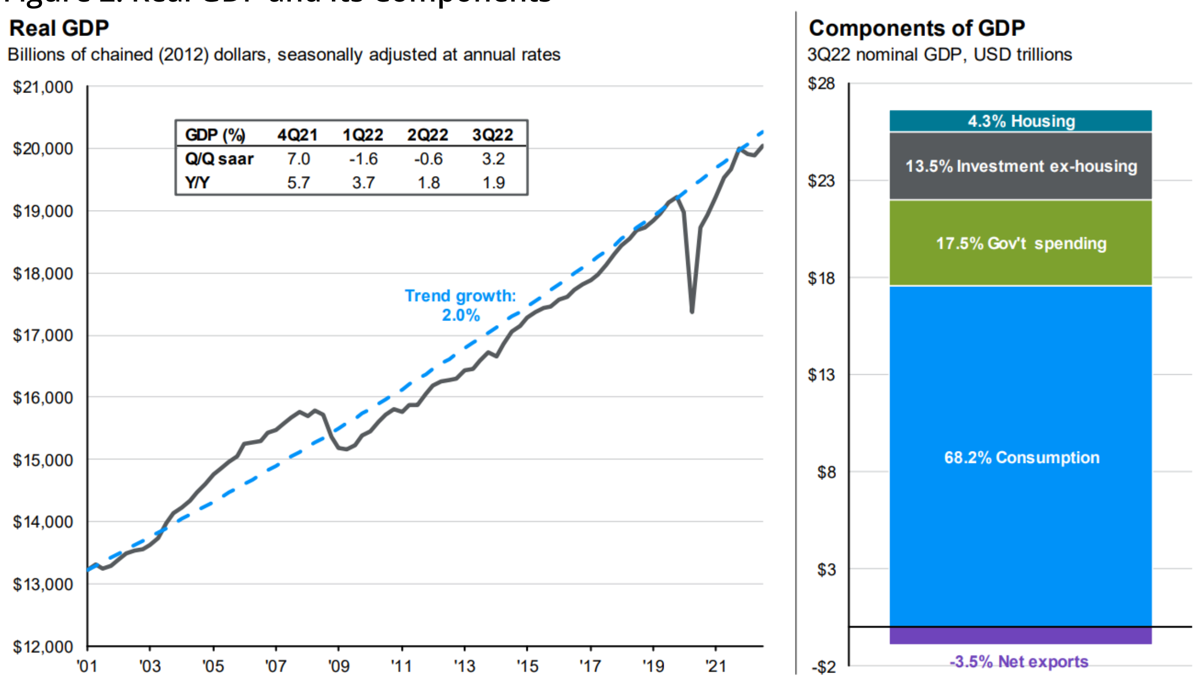
Figure 1. National Bureau of Economic Research – Six Determinates of Recession, 2019-2022



Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Census Bureau, Federal Reserve of St. Louis, NBER, J.P. Morgan Asset Management. Heatmap shading reflects 10 years of data, with green and red reflecting a range of +/- 0.5 standard deviations from a baseline of 0% monthly growth. *The NBER's definition of a recession involves a significant decline in economic activity that is spread across the economy and lasts more than a few months. Because a recession must influence the economy broadly and not be confined to one sector, the committee emphasizes economy-wide measures of economic activity. Specifically, they consider real personal income less transfers, nonfarm payroll employment, employment as measured by the household survey, real personal consumption expenditures, wholesale-retail sales adjusted for price changes and industrial production. There is no fixed rule about which measures contribute to the process or how they are weighted, but the committee notes that "in recent decades, the two measures we have put the most weight on are real personal income less transfers and nonfarm payroll employment."
Guide to the Markets – U.S. Data are as of December 31, 2022.

Recession is defined by the National Bureau of Economic Research (NBER) as a broad decline in six economic variables, which lasts more than a few months, throughout the country. In Figure 1 above, green means expansion and red means we are in a recession. Although there were some orange shades in recent months, there are no red squares at present. Four of the six economic variables – real personal Income, non-farm payroll employment, real consumer spending, and industrial production – were up in the past six months. Only real wholesale and retail sales declined, and household survey employment was flat. Over the past month, household survey unemployment, real consumer spending, real wholesale and retail sales, and industrial production declined, which could mean the US is heading toward a recession. If the US enters a recession, it is likely to be a shallow and could last up to a year, according to consensus reports discussed later in this commentary (See Figures 7 and 8).

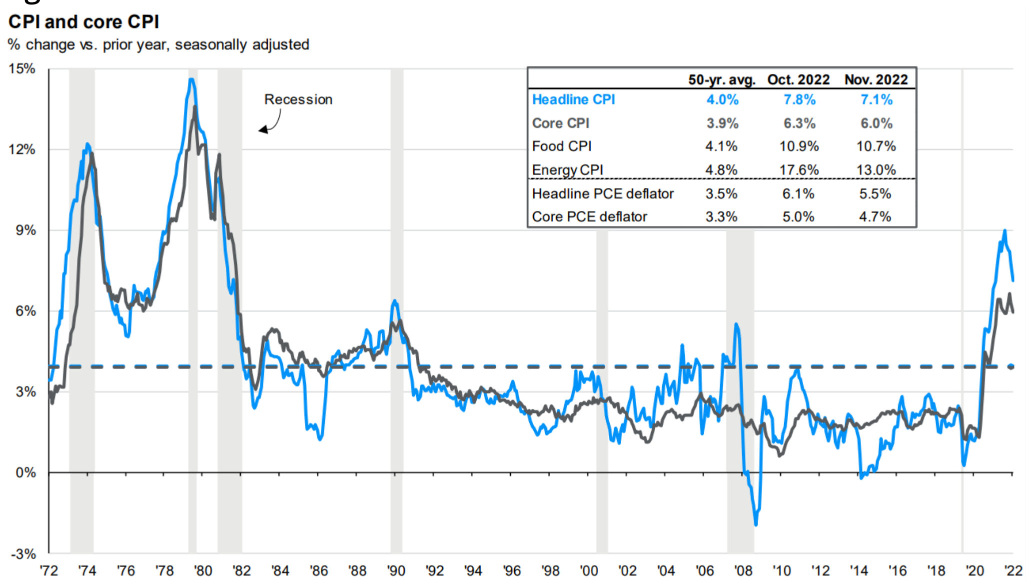
Figure 2. Real GDP and Its Components



Source: BEA, FactSet, J.P. Morgan Asset Management. Values may not sum to 100% due to rounding. Trend growth is measured as the average annual growth rate from business cycle peak 1Q01 to business cycle peak 4Q19.
Guide to the Markets – U.S. Data are as of December 31, 2022.

As seen in Figure 2, GDP has recovered from the pandemic lows, returning to its 2% long term trend. However, against the backdrop of rising interest rates and high inflation, this may not continue. The Conference Board, "currently anticipate(s) three quarters of negative GDP growth starting in Q1 2023." They also predict that, "this downturn will be relatively mild and brief, and growth should rebound in 2024 as inflation ebbs further and the Fed begins to loosen monetary policy." (https://www.conference-board.org/research/us-forecast)

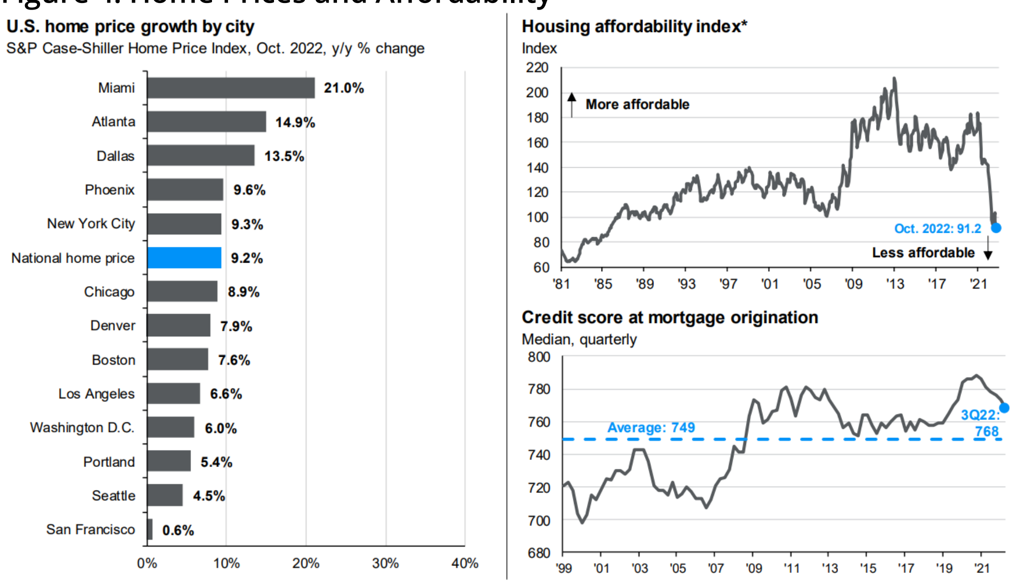
Figure 3. Inflation



Source: BLS, FactSet, J.P. Morgan Asset Management.
CPI used is CPI-U and values shown are % change vs. one year ago. Core CPI is defined as CPI excluding food and energy prices. The Personal Consumption Expenditure (PCE) deflator employs an evolving chain-weighted basket of consumer expenditures instead of the fixed-weight basket used in CPI calculations.
Guide to the Markets – U.S. Data are as of December 31, 2022.

Although headline Consumer Price Inflation is cooling, as shown in Figure 3, it was still at 7.1% as of November 2022, which is higher than the 50-year average by 3.1%. This level of inflation has not been seen since the recession of the 1980s. It is down from its high of nearly 9% earlier in the year, which bodes well for a moderation in interest rate increases and points toward a shallow recession, at worst. If inflation continues to moderate and wages continue to rise, consumers will be able to afford goods again, which will benefit GDP in in the year to come.

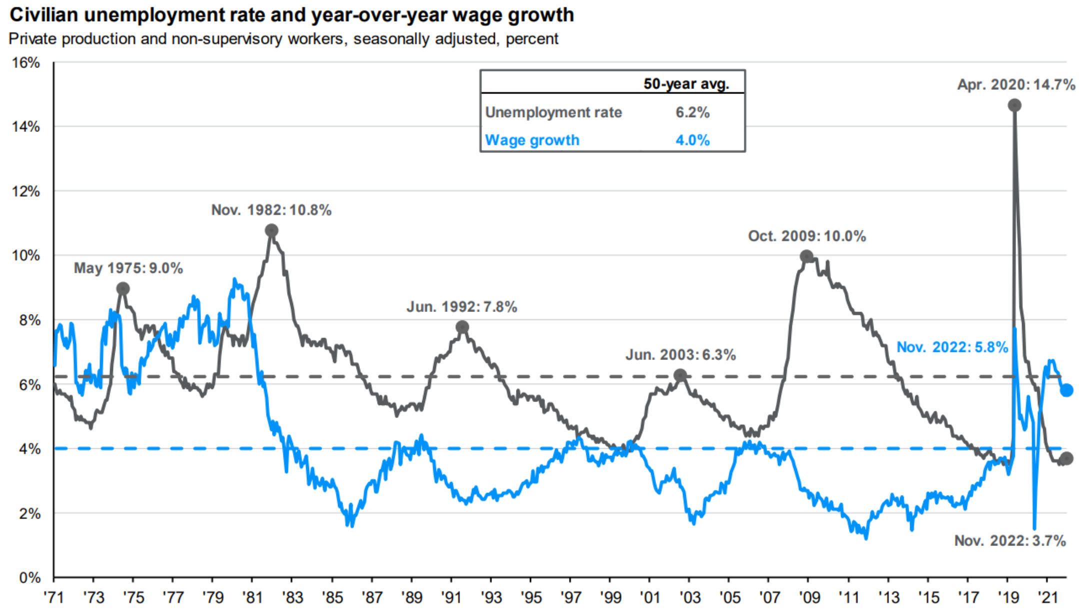
Figure 4. Home Prices and Affordability



Source: J.P. Morgan Asset Management. (Left) FactSet, Robert Shiller, Standard & Poor's; (Top right) U.S. National Association of Realtors; (Bottom right) New York Fed Consumer Credit Panel/Equifax. *Based on the National Association of Realtors methodology, an index value above 100 signifies that a family earning the median income has more than enough income to qualify for a mortgage loan on a median-priced home. The calculation assumes a down payment of 20% of the home price and it assumes a qualifying ratio of 25%.
Guide to the Markets – U.S. Data are as of December 31, 2022.

As shown in Figure 4, housing affordability is at a low not seen since the 1980s. Over the past year, home prices have increased by 9.2%, on average. Homes are even less affordable now than they were in the financial crisis of 2008. This reflects the easy money induced post-COVID surge in new home prices, combined with last year's massive rise in interest rates. Housing is currently incredibly unaffordable, and prices continue to rise in desirable areas. As a result, housing is likely to remain unaffordable for the foreseeable future.

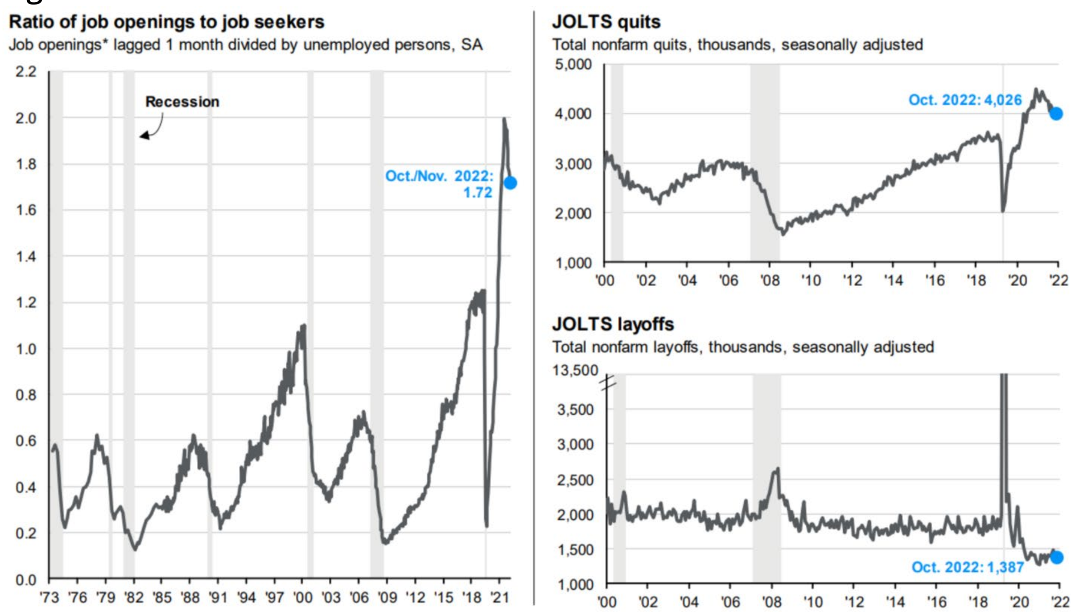
Figure 5. Home Prices and Affordability



Source: BLS, FactSet, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of December 31, 2022.

As shown in Figure 5, the unemployment rate has returned to its pre-pandemic level of 3.7%. At the same time, although wage growth has accelerated over the past year, it recently moderated to 5.8%, well below the pace of the headline CPI, which is 7.1%. This disparity between headline CPI and wage growth makes it more difficult for workers to spend money on anything other than living expenses, especially considering the high cost of housing. With inflation at extreme levels, goods being more expensive as a result, and housing affordability at lows not seen since the early 1980s, workers will continue to demand higher wages. If their demands are granted, either goods prices will continue to rise, or margins will collapse – neither of which underpins a strong economy and either of which could result in a recession.

Figure 6. Labor Demand



Source: U.S. Department of Labor, J.P. Morgan Asset Management. *JOLTS job openings from February 1974 to November 2000 are J.P. Morgan Asset Management estimates.
Guide to the Markets – U.S. Data are as of December 31, 2022.

As shown in Figure 6, the current ratio of job openings to job seekers is at 1.72, down from 1.86 in September. This ratio is still near a high not seen in the past 50 years. With quits declining and layoffs increasing, the labor market will loosen in the coming months. The disparity between job seekers and job openings suggests that there is demand in the workforce that is not being filled – likely due to a mismatch in the skill levels, work environments, and wage demands of jobs available and job seekers. With COVID-related government stimulus fading into the past and inflation pinching budgets and sapping savings, additional workers could return to labor force, which could break the logjam of unfilled jobs.

Figure 7. Consensus Professional Forecasts for Real GDP Growth, CPI Inflation Rate, Unemployment Rate, and 10yr Treasury Yield

	Real GDP growth	CPI inflation rate	Unemployment rate	10-Year Treasury yield
2023				
Consensus (average)	0.3	4.0	4.4	3.8
Average of top 10	1.3	4.6	4.9	4.3
Average of bottom 10	–0.5	3.4	3.9	3.1
Historical performance (1993-2022)				
Accuracy (% of years in range)	46.7	50.0	40.0	36.7
Accuracy (MAFE, consensus)	1.0	0.7	0.5	0.6
Bias (MFE, consensus)	–0.1	0.0	–0.2	–0.5

NOTE: Real GDP and CPI inflation are percent change from 2022 to 2023. Unemployment rate and 10-year Treasury yield are the averages for 2023. The 2022 observed values were calculated with data through 2022:Q3. Mean absolute forecast error (MAFE) and mean forecast error (MFE) were calculated using the consensus forecast.

Source: https://research.stlouisfed.org/publications/economic-synopses/2023/01/06/professional-forecasters-outlook-for-2023-and-caveats-based-on-past-performance

Figure 7 is a consensus of multiple professional forecasts brought together by the St. Louis Federal Reserve for 2023. This chart looks at the average top ten and average bottom ten, along with their consensus averages, for real GDP growth, CPI inflation rate, unemployment rate, and the 10-year treasury yield. The consensus for real GDP growth for 2023 is only 0.3%, well below the historic average of 2% for real GDP growth. The consensus for CPI inflation rate is 4.0, meaning that forecasters project that by the end of 2023, inflation will return to its 50-year average, or at least close to it. The consensus forecasts that the unemployment rate will increase from its current rate of 3.7% to 4.5%. As noted in the chart, these forecasts are not always accurate and should be viewed cautiously.

Figure 8. The Conference Board Consensus US Economic Outlook, 2012-2024 (Jan)

	2021				2022				2023				2024				2020*	2021*	2022	2023	2024
	I Q*	II Q*	III Q*	IV Q*	I Q*	II Q*	III Q*	IV Q	I Q	II Q	III Q	IV Q	I Q	II Q	III Q	IV Q					
Real GDP	6.3	7.0	2.7	7.0	−1.6	−0.6	3.2	1.9	−0.6	−1.7	−0.5	1.1	3.0	2.5	2.2	2.3	−2.8	5.9	2.0	0.2	1.7
Real GDP (YoY)	1.2	12.5	5.0	5.7	3.7	1.8	1.9	0.7	1.0	0.7	−0.2	−0.4	0.5	1.5	2.2	2.5	−2.8	5.9	2.0	0.2	1.7
Real disposable income	52.4	−28.8	−4.6	−4.9	−10.6	−2.3	1.0	2.5	1.0	0.5	0.3	0.6	1.0	1.7	1.8	1.9	6.2	1.9	−6.5	0.9	1.0
Real consumer spending	10.8	12.1	3.0	3.1	1.3	2.0	2.3	2.7	−0.4	−1.5	−0.4	0.4	2.9	2.4	2.0	1.8	−3.0	8.3	2.8	0.5	1.5
Residential investment	11.6	−4.8	−5.8	−1.1	−3.1	−17.8	−27.1	−25.0	−10.0	−10.0	−5.0	−1.0	1.0	2.0	3.0	4.0	7.2	10.7	−10.6	−14.9	−0.3
Nonresidential investment	8.9	9.9	0.6	1.1	7.9	0.1	6.2	4.7	−1.7	−4.0	−1.5	1.9	3.6	4.0	4.5	5.0	−4.9	6.4	3.9	0.3	2.4
Inventory change (bln chn '12$)	−83.0	−144.0	−49.0	198.0	215.0	110.0	39.0	5.0	2.0	−8.0	−20.0	0.0	10.0	5.0	0.0	0.0	−55.0	−19.0	92.0	−7.0	3.8
Total gov't spending	6.5	−3.0	−0.2	−0.9	−2.3	−1.6	3.7	2.0	2.0	2.5	2.5	2.7	2.4	2.4	2.4	2.4	2.6	0.6	−0.7	2.2	2.5
Exports	0.4	4.8	−1.1	23.5	−4.6	13.8	14.6	1.0	−2.0	−2.0	0.0	1.0	1.5	2.0	2.0	2.0	−13.2	6.1	7.4	1.8	1.2
Imports	7.6	7.9	6.6	18.6	18.4	2.3	−7.3	−2.0	−1.0	−1.7	0.4	2.5	2.0	2.0	2.5	2.5	−9.0	14.1	8.3	−1.6	1.8
Unemployment rate (%)	6.2	5.9	5.1	4.2	3.8	3.6	3.6	3.6	3.5	3.7	4.2	4.5	4.5	4.4	4.2	4.1	8.1	5.4	3.6	4.0	4.3
Labor Force Participation Rate (%)	61.4	61.6	61.7	61.9	62.3	62.2	62.2	62.2	62.3	62.2	62.0	61.8	61.8	61.8	61.8	61.9	61.7	61.7	62.2	62.1	61.8
PCE Inflation (%Y/Y)	1.9	4.0	4.5	5.7	6.4	6.6	6.3	5.6	4.6	3.6	3.2	2.8	2.5	2.3	2.1	2.0	1.1	4.0	6.2	3.5	2.2
Core PCE Inflation (%Y/Y)	1.7	3.5	3.9	4.7	5.3	5.0	4.9	4.7	4.0	3.6	3.1	2.8	2.5	2.3	2.1	2.0	1.3	3.5	5.0	3.4	2.2
Fed Funds (%, Midpoint, Period End)	0.125	0.125	0.125	0.125	0.375	1.625	3.125	4.375	4.875	4.875	4.875	4.875	4.625	4.125	3.625	3.375	0.125	0.125	4.375	4.875	3.375

Source: https://www.conference-board.org/research/us-forecast

Figure 8 shows another consensus outlook on the economy made by The Conference Board with projections moving out to 2024. As shown in the chart, 2023 is likely to be a year of very slow growth or recession, with Real GDP flat to down, real disposable income and consumer spending flat, residential investment plunging, government spending rising, exports up (likely due to fossil fuels), imports falling, unemployment rising, labor force participation rates falling, and the FED funds rising. All of this together paints a picture of a bad year for the economy and likely a shallow recession. However, many of these number are projected to get much better in 2024, showing an economic rebound by then. If we are in for hardship, it is likely to only last 3 quarters to a year at most, as is corroborated by many consensus opinions. Again, while these are not always accurate, they help to paint a picture of what we can expect in the time to come.

Things to watch out for:

- A shallow recession in the upcoming three quarters to a year, followed by economic growth.
- A stagnation or fall in GDP.
- High inflation and the FEDs attempt to fight it.
- Housing prices remaining at extreme highs.
- Rising unemployment amid more job seekers, fewer job openings, and higher layoffs.

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