November 2022
Economic Overview

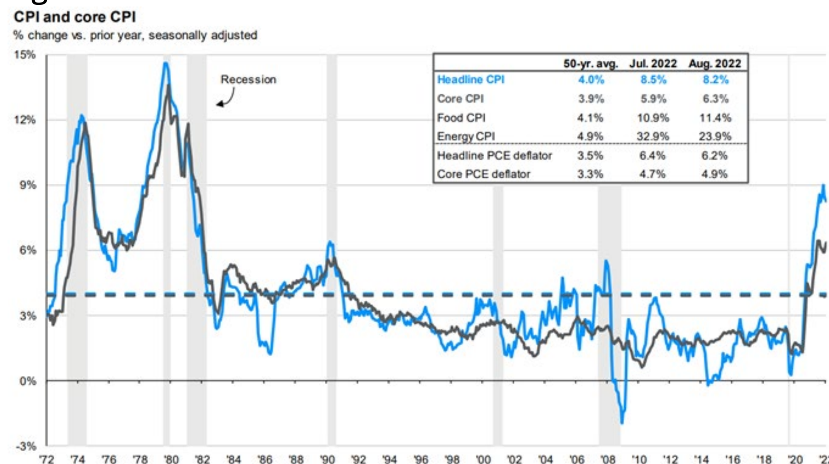
First Affirmative
FINANCIAL NETWORK
Invest for a Sustainable Future

By Richard Frankel

Summary:

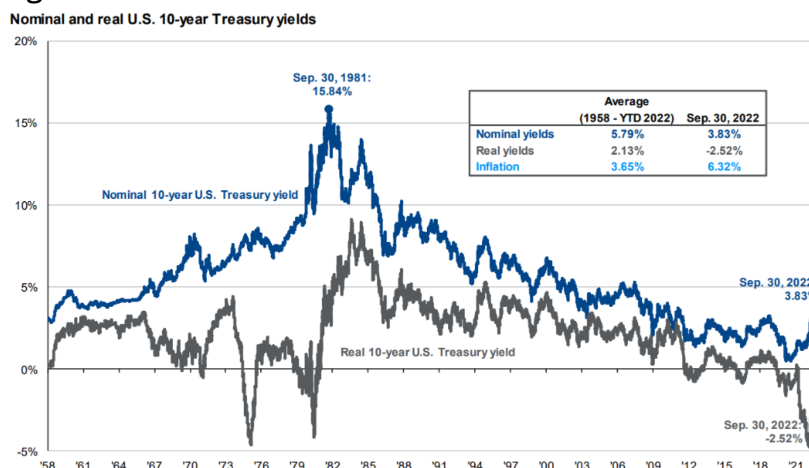
- Inflation is extremely high, and the Fed is trying to combat it by raising interest rates.
- Consumer sentiment is at a more than 40-year low.
- Housing affordability is at an extreme low.
- The ratio of job openings to jobseekers is high, and the unemployment rate has returned to pre-pandemic levels.
- Wage growth is not keeping up with inflation.
- We are likely heading toward, or already in the beginnings of, a recession.

Figure 1. Inflation



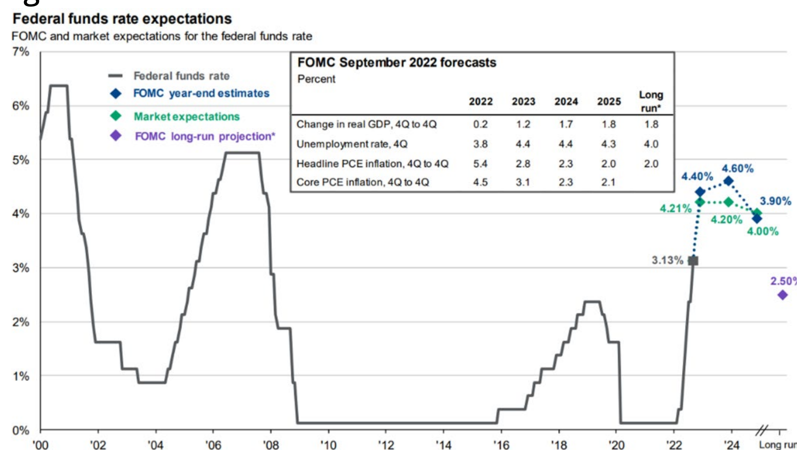
As seen in Figure 1, as of August 2022, headline CPI and core CPI are sitting at levels not seen since the recession of 1981. The headline CPI is at 8.2%, which is more than double the 50-year average of 4%. The Core CPI is at 6.3%, which is 2.4 percentage points above the 50-year average. Food inflation is 11.4%, nearly triple the 50-year average of 4.1% and energy price inflation is a whopping 23.9% -- down from September 2022, but still more than quadruple the 50-year average of 4.9%. These numbers reflect the extreme levels of consumer inflation right now. For the consumer price index to be so high, and to have goods cost so much, shows an erosion of purchasing power that is unprecedented in the last 40 years.

Figure 2. Interest Rates and Inflation



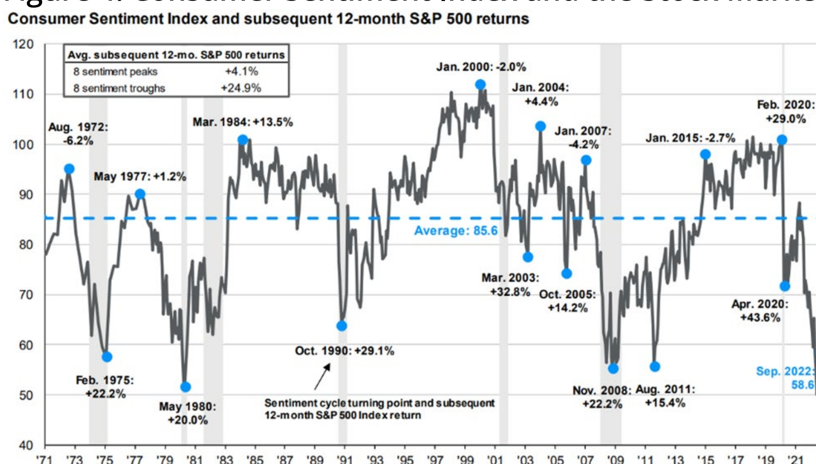
As seen in Figure 2, nominal and real US 10-year treasury yields have risen sharply over the past year. As of the end of September 2022, nominal yields were sitting at 3.83%, while real yields remain significantly negative at -2.52%. At the same time, inflation is 6.32%; although nominal interest rates have increased, the negative real yield suggests that further interest rate increases are imminent. The Fed raised rates on November 2nd by 75 more basis points, demonstrating their commitment to combating high inflation with higher interest rates (https://www.cnbc.com/2022/11/02/fed-raises-borrowing-costs-with-another-jumbo-interest-rate-hike.html). We will likely continue to see the Fed Funds rate rise through 2023, when JP Morgan expects they will peak at around 4.6%, as seen in Figure 3.

Figure 3. The FED and Interest Rates



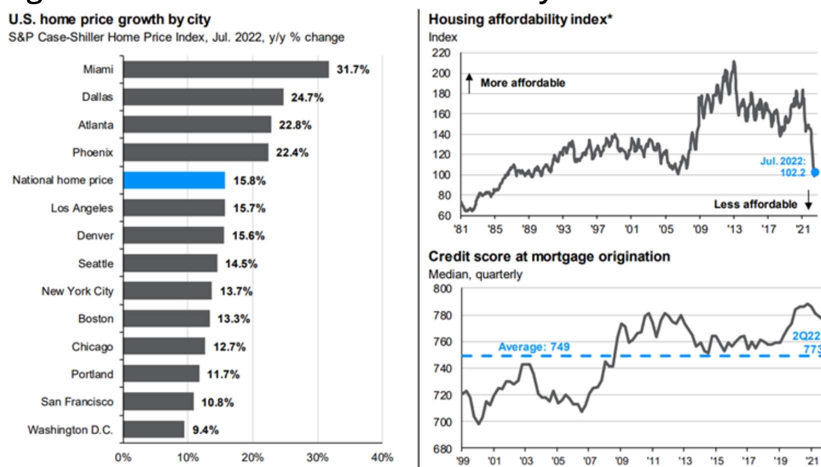
As seen in Figure 3, JP Morgan's federal fund rate expectations show a continued steep rise in rates in the near term. As previously stated, the Fed recently raised interest rates 75 basis points, and this behavior is unlikely to stop against the backdrop of the incredibly high inflation being experienced. We are likely to see interest rate peak in 2023, and it is unlikely that we will see rates fall until inflation moderates in late 2024, when hopefully the economy will be in better shape.

Figure 4. Consumer Sentiment Index and the Stock Market



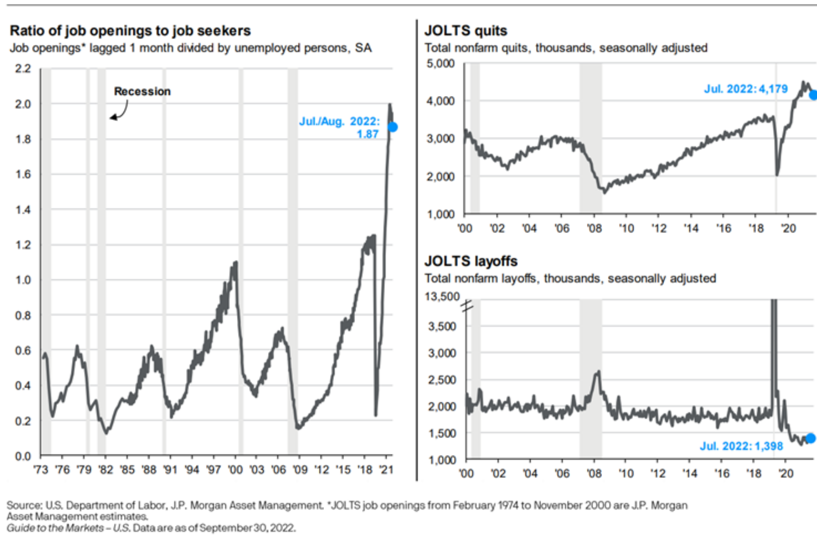
As seen in Figure 4, while consumer sentiment did rise since August, it is still at a low not seen since the financial crisis of 2008 and has not seen levels like these since May 1980. This level of consumer confidence augurs poorly for near term economic activity. However, as shown in the chart it appears that consumer sentiment bottomed out in August and has since bounced back from its August low. In the past, consumer sentiment troughs have heralded significant increases in the S&P 500 in subsequent 12 months.

Figure 5. Home Prices and Affordability



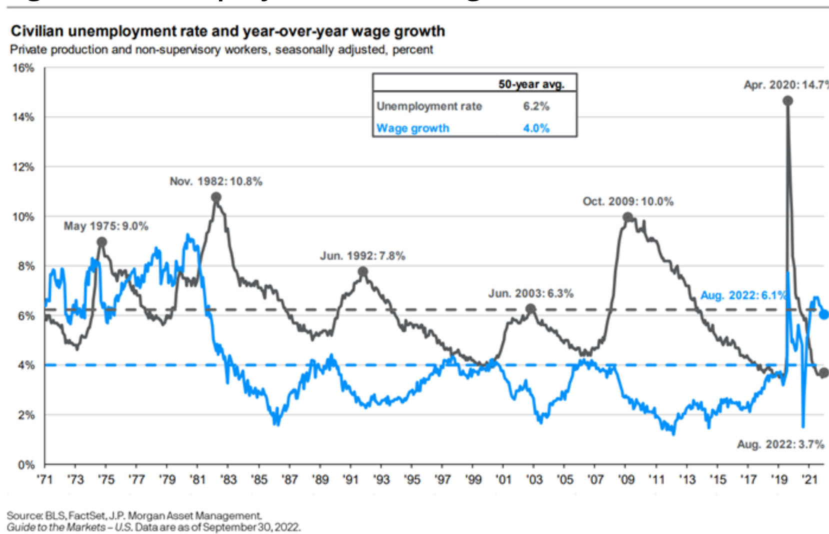
As seen in Figure 5, the average national home price has gone up by 15.8% over the past year, making homes as unaffordable now as they were during the financial crisis of 2008. In addition to reflecting the pandemic-induced surge in housing prices, the sharp decline in affordability reflects the more than doubling in mortgage rates over the past year. All of this suggests home prices are likely to fall in the coming months.

Figure 6. Labor Demand



As seen in Figure 6, the current ratio of job openings to job seekers is 1.87, a high not seen in the past 50 years. People quitting their jobs are at a high not seen in the past 20 years. Layoffs are at a low not seen in the past 20 years. The disparity between job seekers and job openings suggests that the demand for workers will continue to outpace supply. Clearly, open jobs are not paying high enough wages to attract workers – which does not bode well for inflation.

Figure 7. Unemployment and Wages



As seen in Figure 7, the unemployment rate has returned to pre-pandemic levels at 3.7%. At the same time, though wage growth has risen over the past year, it recently dropped to 6.1%, which is far lower than the level of inflation at 8.2% headline CPI. This disparity between headline CPI and worker's wage growth makes it more difficult for workers to spend money on anything but living expenses, especially considering the high cost of housing previously discussed in figure 5. With goods more expensive, inflation rising, and housing unaffordable, all into the foreseeable future, workers' wages must increase.

Things to watch out for:

- Rising inflation and the Fed's attempt to combat it through high interest rates.
- Possible increases in the S&P 500 in the next 12 months as heralded by the bottoming of the consumer sentiment index.
- Record low housing affordability.
- Rising wages alongside a lower ratio of workers to job openings.
- Continued possibility of a recession if we are not already in the midst of one.

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