

Economy Watch

Inflation, Labor Markets, and the Fed

May 11, 2022



Some of the critical questions and issues we will be answering today

- What is The Conference Board's current forecast for the US economy?
- What's underpinning tightness in the labor market and what is likely to happen in the future?
- Why is inflation hitting 40-year highs and how much longer will this last?
- What is the Federal Reserve doing to address these forces and how much can it realistically accomplish?



Today's Speakers



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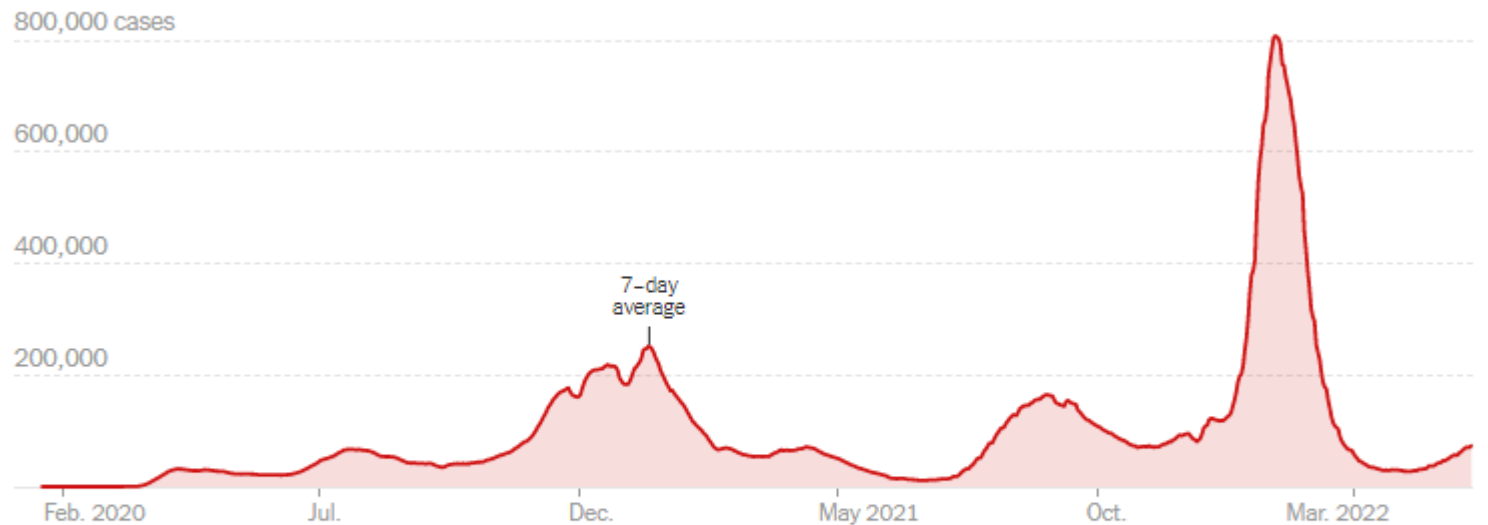


US Economic Outlook

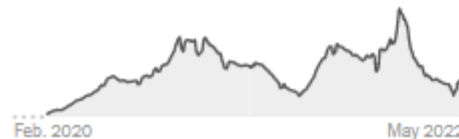
New cases of COVID-19 trend higher, but remain well below previous peaks

- New cases of COVID-19 plummeted following Omicron wave but are trending higher.
- Pandemic restrictions have largely been lifted as the US returns to normality.
- US officials have noted that while the virus is not behind us about 90% of Americans have some degree of immunity.
- COVID-19 rates in other parts of the world are somewhat concerning, notably in China where numerous cities, including Shanghai, are under lockdown.

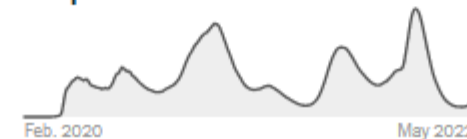
New reported cases



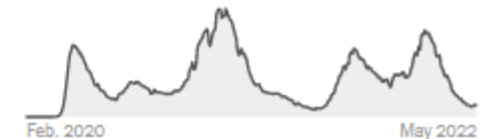
Tests



Hospitalized



Deaths

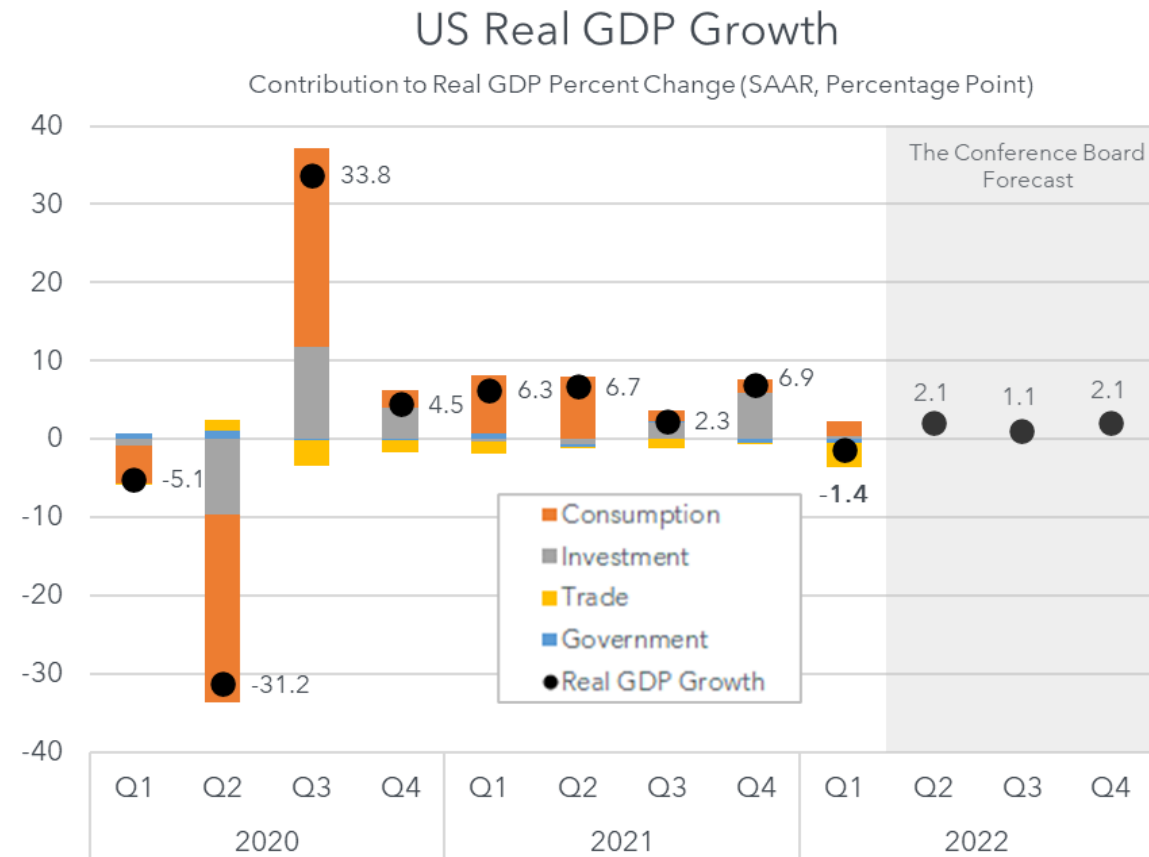


Source: New York Times



Economic fundamentals sound despite Q1 2022 GDP contraction

- GDP growth in Q1 2022 came in lower than expected due to elevated import growth and lower inventory restocking.
- While at first glance the headline figure suggests that the US economy may be on the verge of a recession, core economic activity held up fairly well.
- Business investment rose 9.2 percent and consumer spending was up 2.7 percent in Q1 2022.
- While we do not anticipate a recession in the near-term, risks related to inflation, labor markets, and monetary policy should be closely monitored.



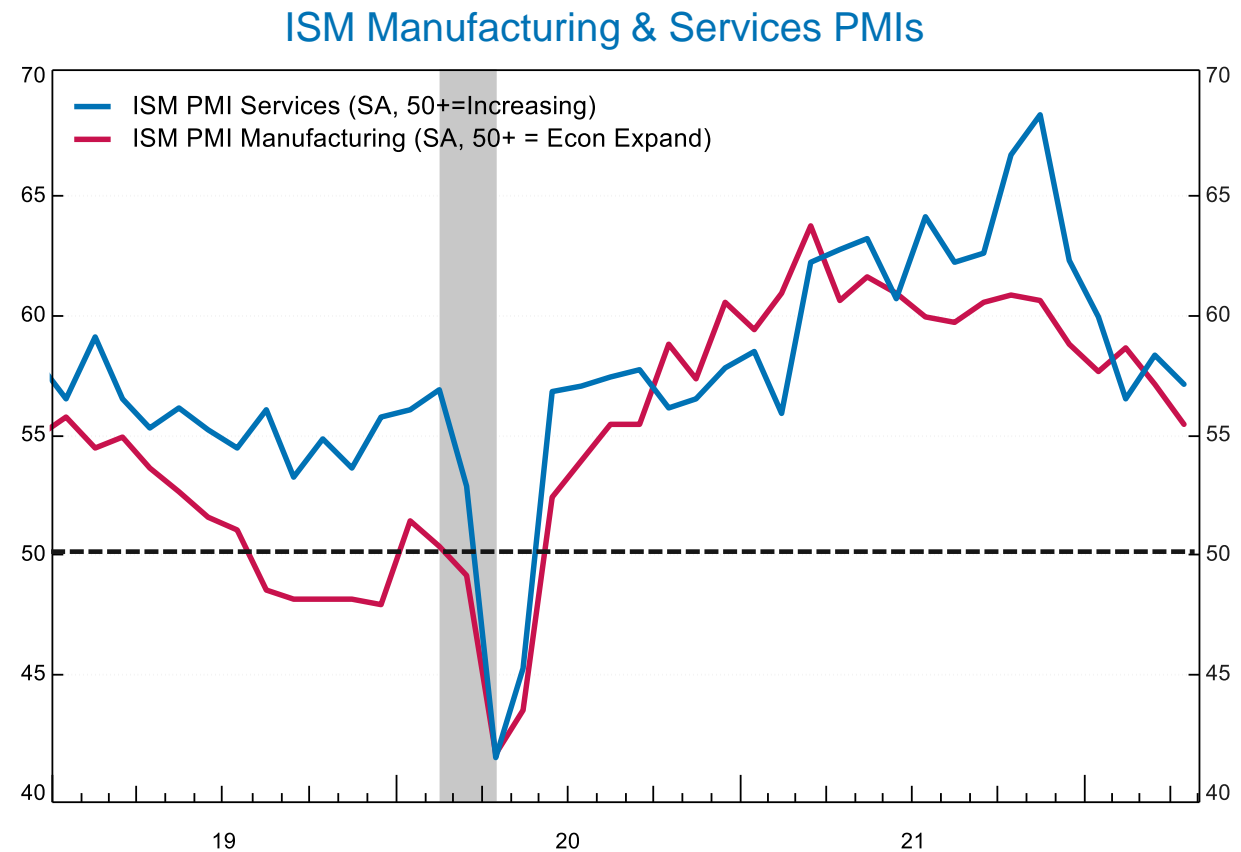
Source: The Conference Board, BEA

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Economic activity expanded in April, though at a more moderate pace

- Initial economic indicators for April show continued growth, although at a more moderate pace.
- Both the Manufacturing and Services PMIs fell for the month but remain well-above the critical 50 breakeven point.
- Survey respondents cited strong demand, but restrained supply.
- Concerns about labor availability, input costs, and energy prices were said to be impediments to business activity.
- The war in Ukraine and COVID-19 lockdowns in China were said to hurting business activity.



Source: Institute for Supply Management



Ukraine crisis weighs on US economic growth & inflation outlook

THE CONFERENCE BOARD US ECONOMIC OUTLOOK, 2019-2020-2021-2022-2023 Percentage Change, Seasonally Adjusted Annual Rates*

	2020				2021				2022				2023				2019*	2020	2021	2022*	2023*
	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	-5.1	-31.2	33.8	4.5	6.3	6.7	2.3	6.9	-1.4	2.1	1.1	2.1	2.3	2.3	2.2	2.2	2.3	-3.4	5.7	2.3	2.1
Real GDP (YoY)	0.6	-9.1	-2.9	-2.3	0.5	12.2	4.9	5.5	3.6	2.4	2.1	1.0	1.9	2.0	2.2	2.3	2.3	-3.4	5.7	2.3	2.1
Real disposable income	3.1	48.5	-16.6	-8.3	54.7	-29.1	-4.1	-5.6	-2.0	-2.0	-1.0	1.0	1.5	2.0	2.3	2.7	2.3	6.2	2.2	-4.7	1.1
Real consumer spending	-6.9	-33.4	41.4	3.4	11.4	12.0	2.0	2.5	2.7	1.9	1.1	1.6	1.7	1.8	1.8	1.8	2.2	-3.8	7.9	2.7	1.6
Residential investment	20.3	-30.8	60.0	34.4	13.3	-11.7	-7.7	2.1	2.1	2.0	0.5	1.0	1.0	1.0	1.5	1.5	-0.9	6.8	9.2	-0.4	1.1
Nonresidential investment	-8.1	-30.3	18.7	12.5	12.9	9.2	1.6	2.9	9.2	8.2	5.7	4.0	4.3	4.0	3.8	3.4	4.3	-5.3	7.4	6.1	4.4
Inventory change (bln chn '12\$)	-30	-253	25	89	-88	-169	-67	193	159	120	60	45	45	45	30	20	75	-42	-33	96	35
Total gov't spending	3.7	3.9	-2.1	-0.5	4.2	-2.0	0.9	-2.6	-2.7	0.6	2.0	3.6	4.2	4.2	4.4	4.4	2.2	2.5	0.5	-0.6	3.6
Exports	-16.3	-59.9	54.5	22.5	-2.9	7.6	-5.3	22.4	-5.9	10.1	5.1	3.7	4.6	4.0	3.5	3.5	-0.1	-13.6	4.5	4.8	4.5
Imports	-13.1	-53.1	89.2	31.3	9.3	7.1	4.7	17.9	17.7	5.0	1.5	2.0	4.0	4.0	3.0	3.0	1.1	-8.9	14.0	9.8	3.2
Unemployment rate (%)	3.8	13.0	8.8	6.8	6.2	5.9	5.1	4.2	3.8	3.5	3.4	3.2	3.1	3.0	2.9	2.8	3.7	8.1	5.4	3.5	2.9
PCE Inflation (%Y/Y)	1.7	0.6	1.2	1.2	1.8	3.9	4.3	5.5	6.3	6.6	6.3	4.2	3.4	3.0	2.9	2.7	1.5	1.2	3.9	5.8	3.0
Core PCE Inflation (%Y/Y)	1.8	1.0	1.5	1.4	1.7	3.4	3.6	4.6	5.2	5.9	5.1	4.4	3.4	2.9	2.8	2.6	1.7	1.4	3.3	5.2	2.9

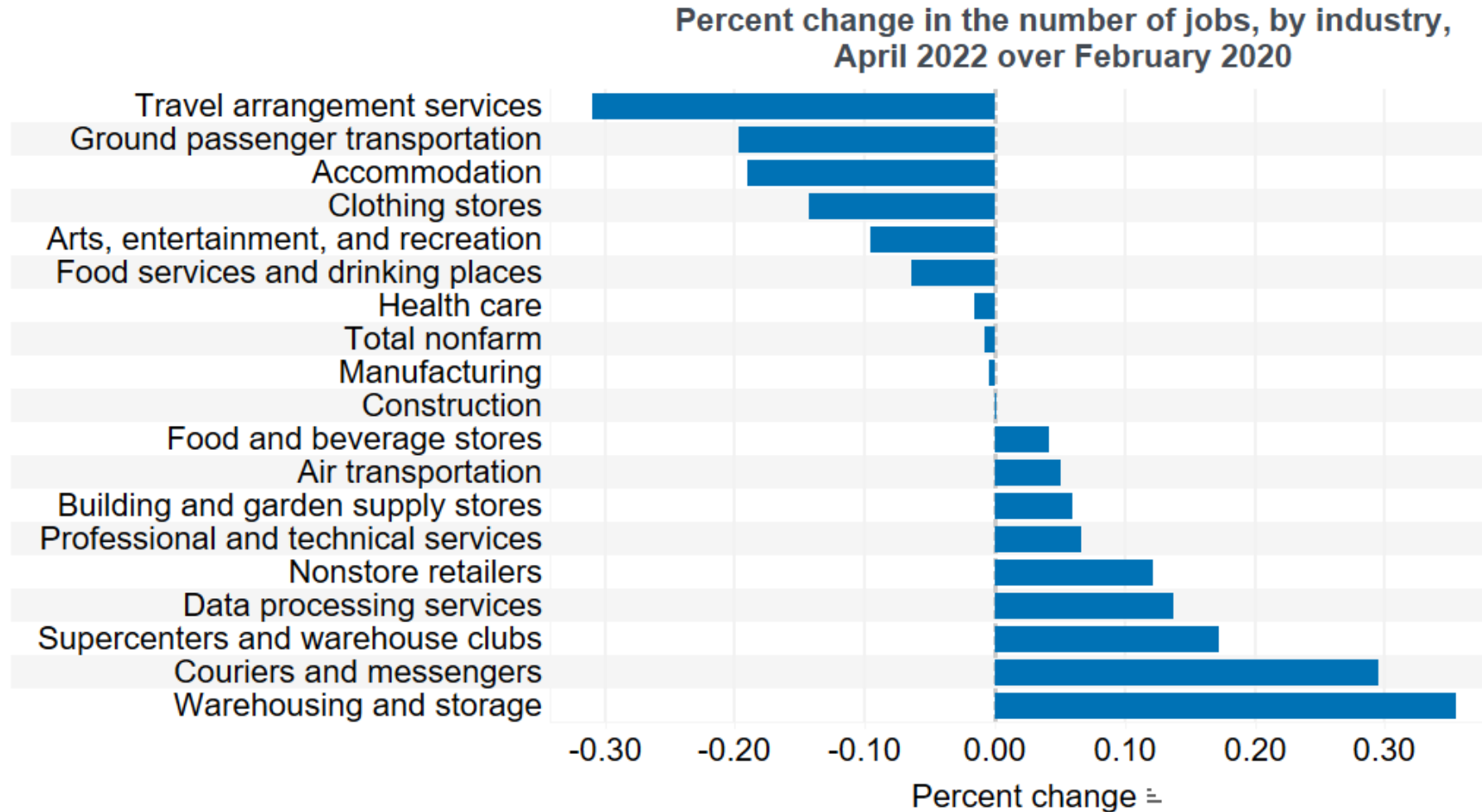
Source: The Conference Board

*Units: Quarterly growth rates are QoQ SAAR unless otherwise noted.
Annual growth rates are year-over-year unless otherwise noted



US Labor Markets

Employment is below pre-pandemic levels for some industries

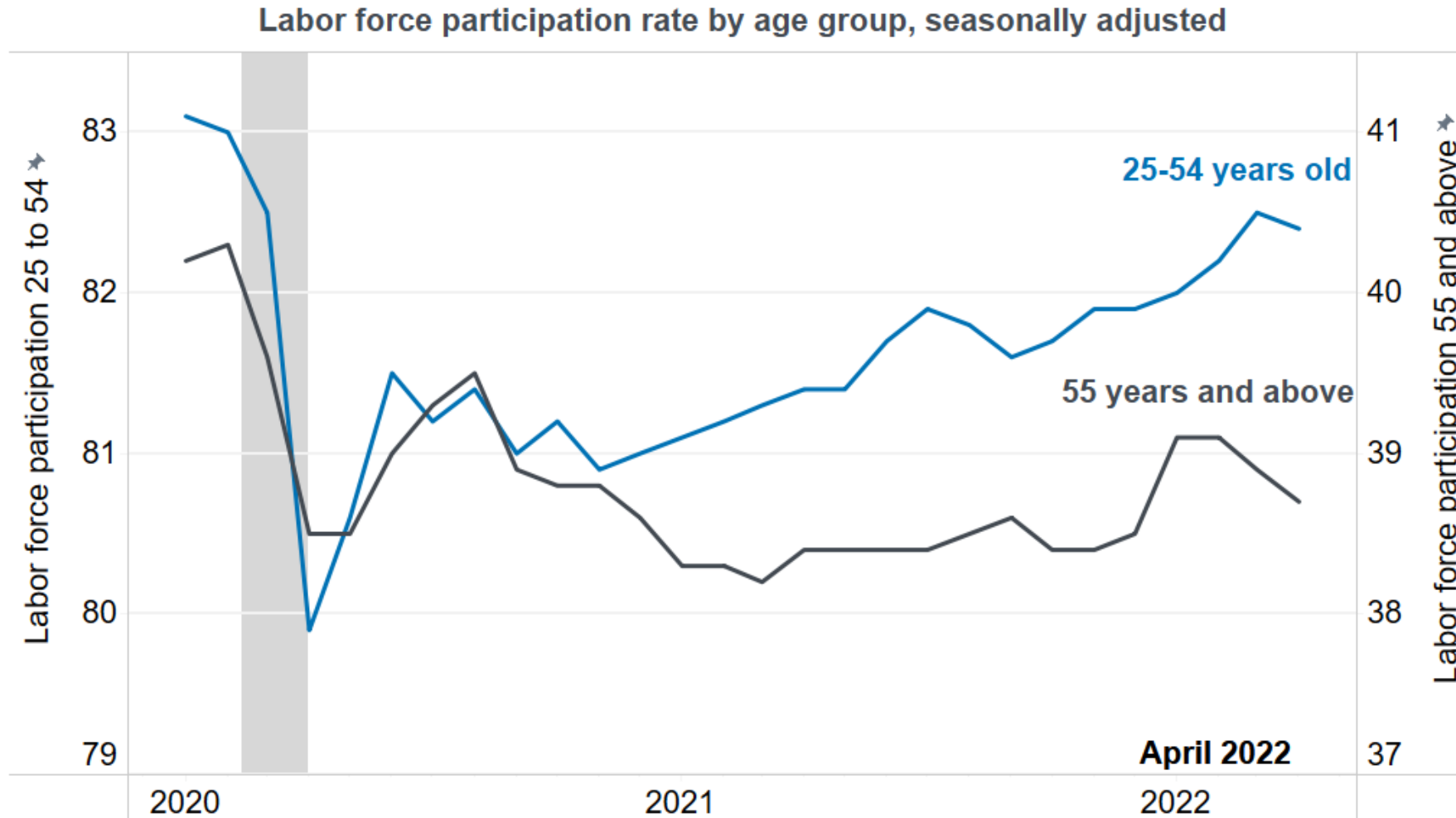


Source: US Bureau of Labor Statistics

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Labor force participation remains below pre-pandemic rate

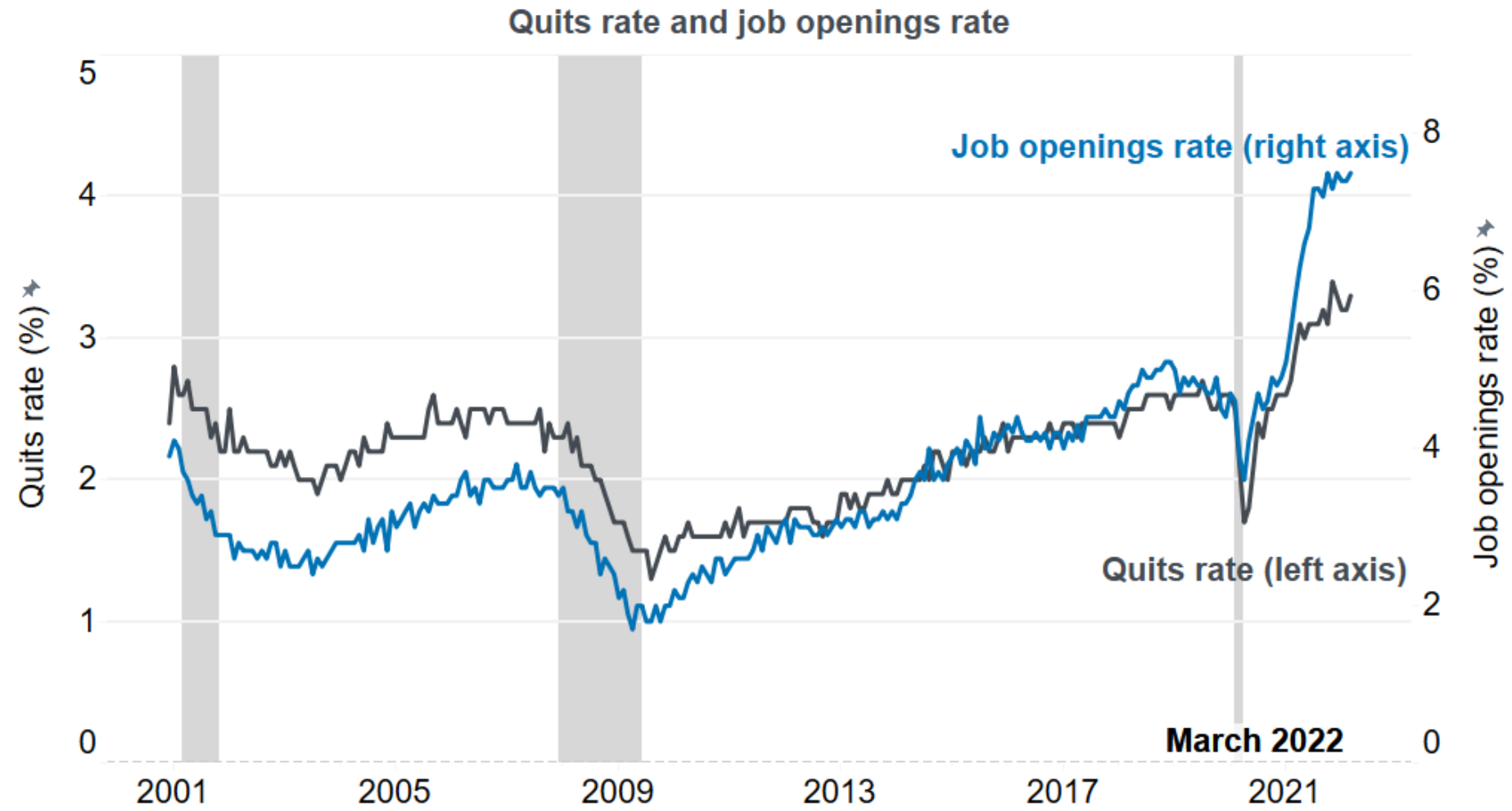


Source: US Bureau of Labor Statistics

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Labor shortages continue to impact recruiting and retention

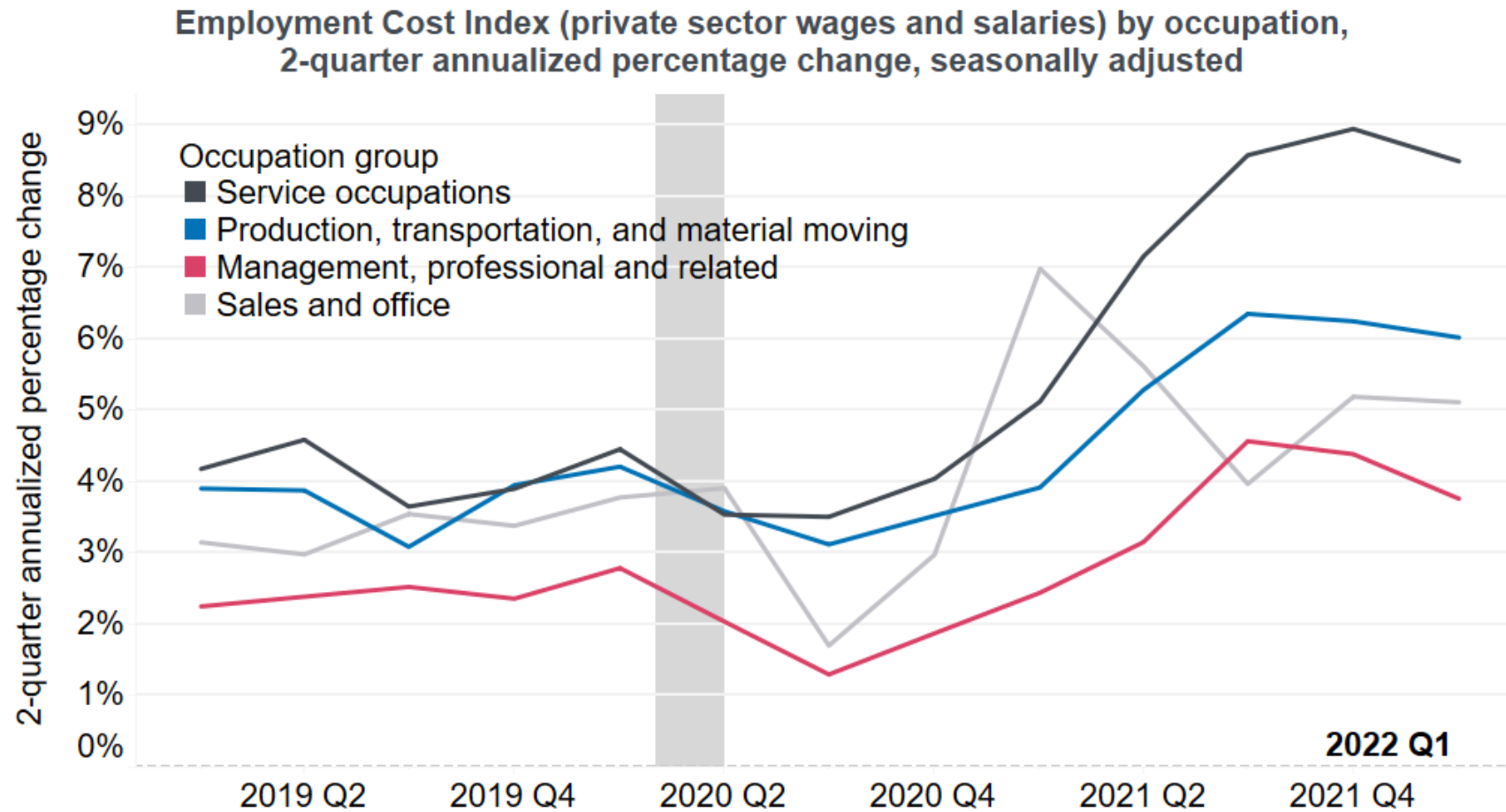


Source: US Bureau of Labor Statistics

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Wage growth is still high, especially in service occupations



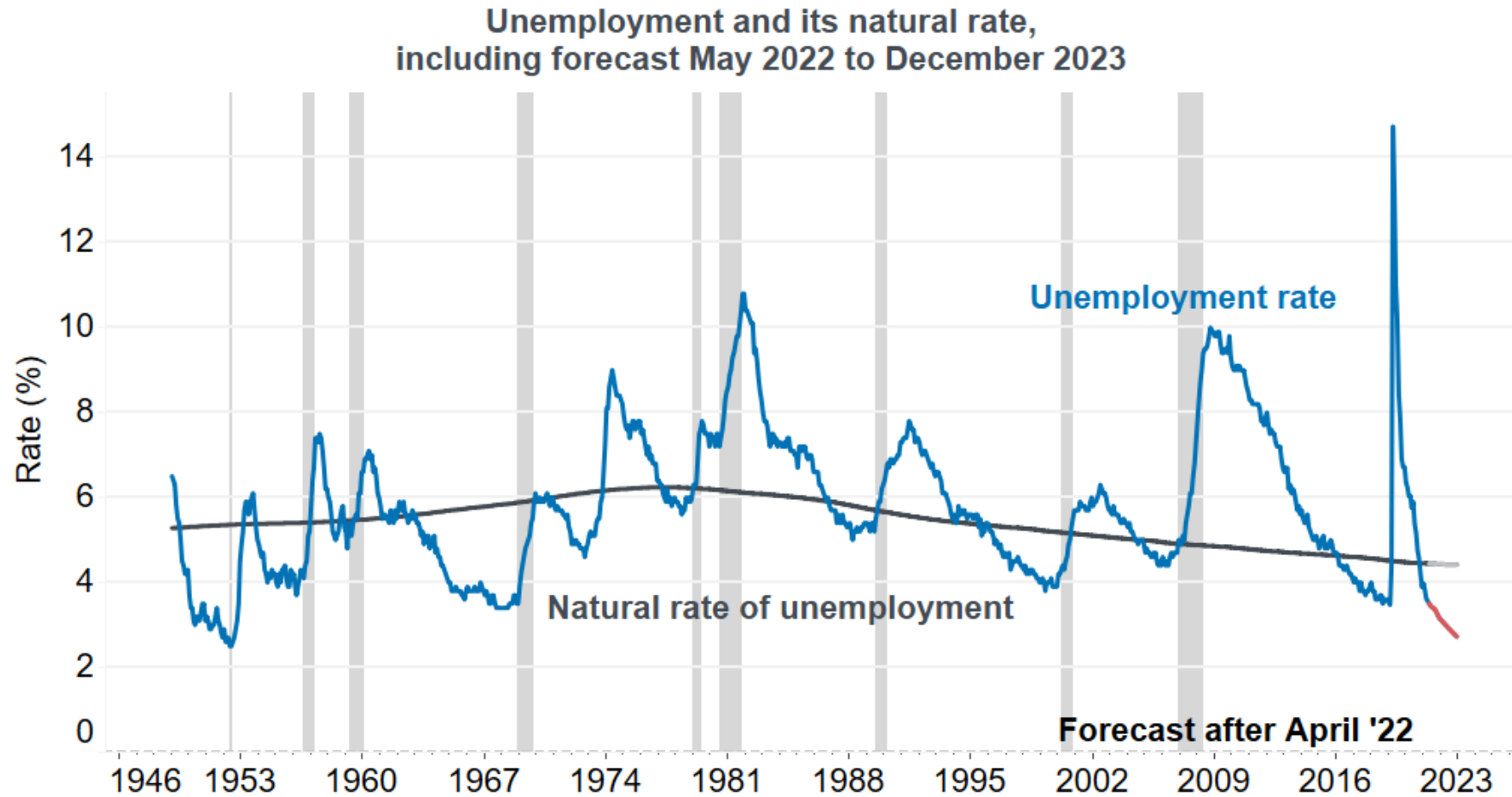
Note: Shaded area represents recession.

Source: US Bureau of Labor Statistics

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Labor market will remain tight as unemployment rate approaches 3 percent



Sources: Congressional Budget Office;
US Bureau of Labor Statistics; The Conference Board

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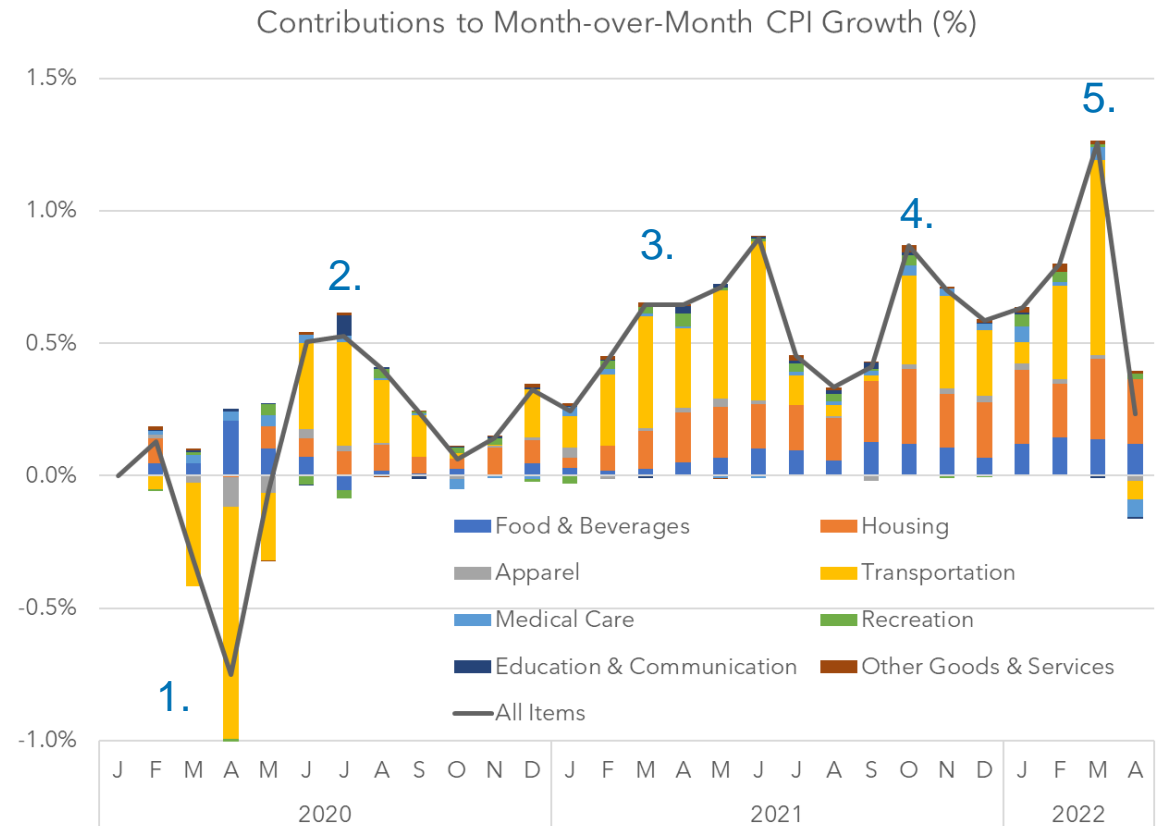


US Inflation

Inflation drivers over the last two years have evolved over time

Following a brief collapse in prices in early 2020, several waves of inflation have hit the US economy.

1. During the lockdown in early 2020 economic activity ground to a halt and prices for many goods and services collapsed resulting in disinflation.
2. As the economy reopened prices rebounded as some demand resurfaced.
3. Government stimulus coupled with supply chain disruption led a prolonged wave of inflation in early 2021.
4. With supply chains still stretched, a rise in energy prices exacerbated price increases in late 2021.
5. The invasion of Ukraine has recently sent energy prices soaring.



Source: BLS, The Conference Board

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What are the current drivers of inflation?

Current Drivers:

- Strong demand for goods
- Emerging demand for services
- Energy price volatility
- Easy monetary, fiscal policy
- Strong Demand for Housing
- Factory Closures Abroad
- Supply Chain Bottlenecks
- Transportation Costs
- Commodity Price Spikes
- Semiconductor Shortage
- Wages – Labor Shortages
- Wages – Great Resignation



Inflation Outlook for 2022 and 2023

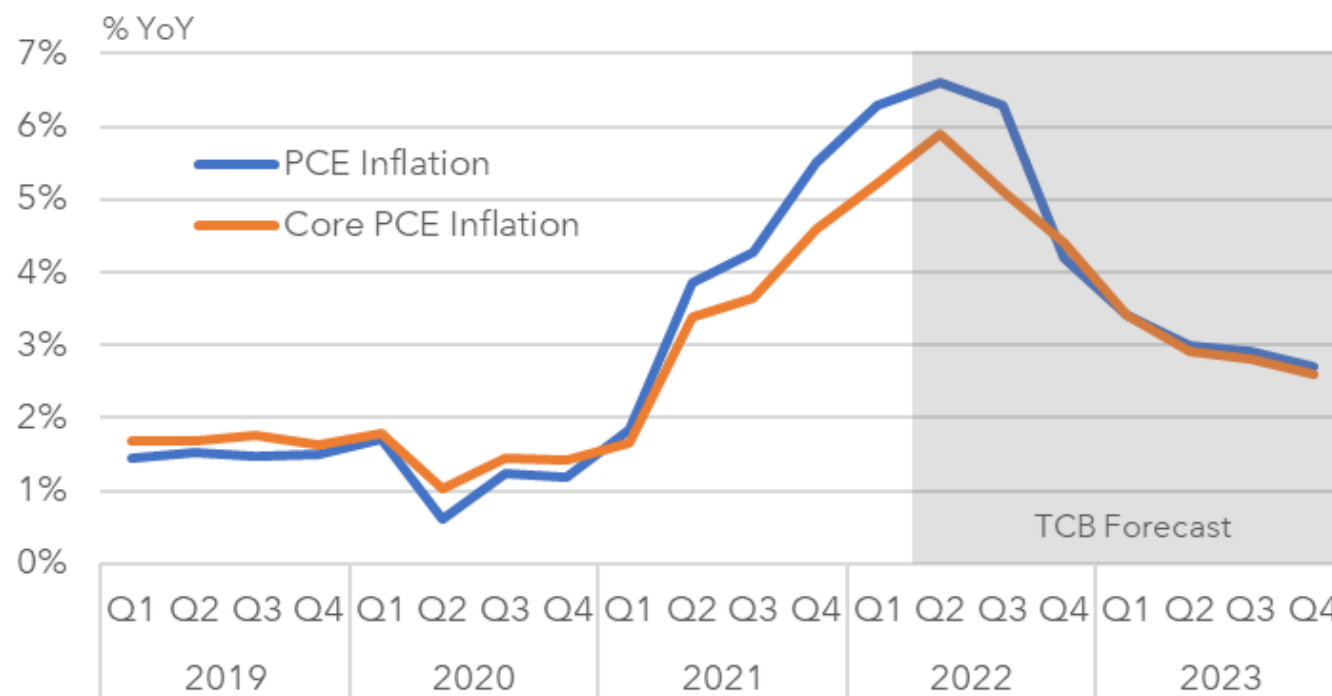
Key Assumptions:

- Higher interest rates cool demand
- Demand for goods wanes as consumers pivot back to services.
- Supply chain disruptions persist, for a time, before easing somewhat.
- Energy and commodity prices moderate over time.
- Labor market tightness eases somewhat.

Key Takeaways:

- Year-over-year inflation rates should peak in Q2 2022 or Q3 2022.
- Inflation will not revert to pre-pandemic rates.

PCE Inflation Forecast



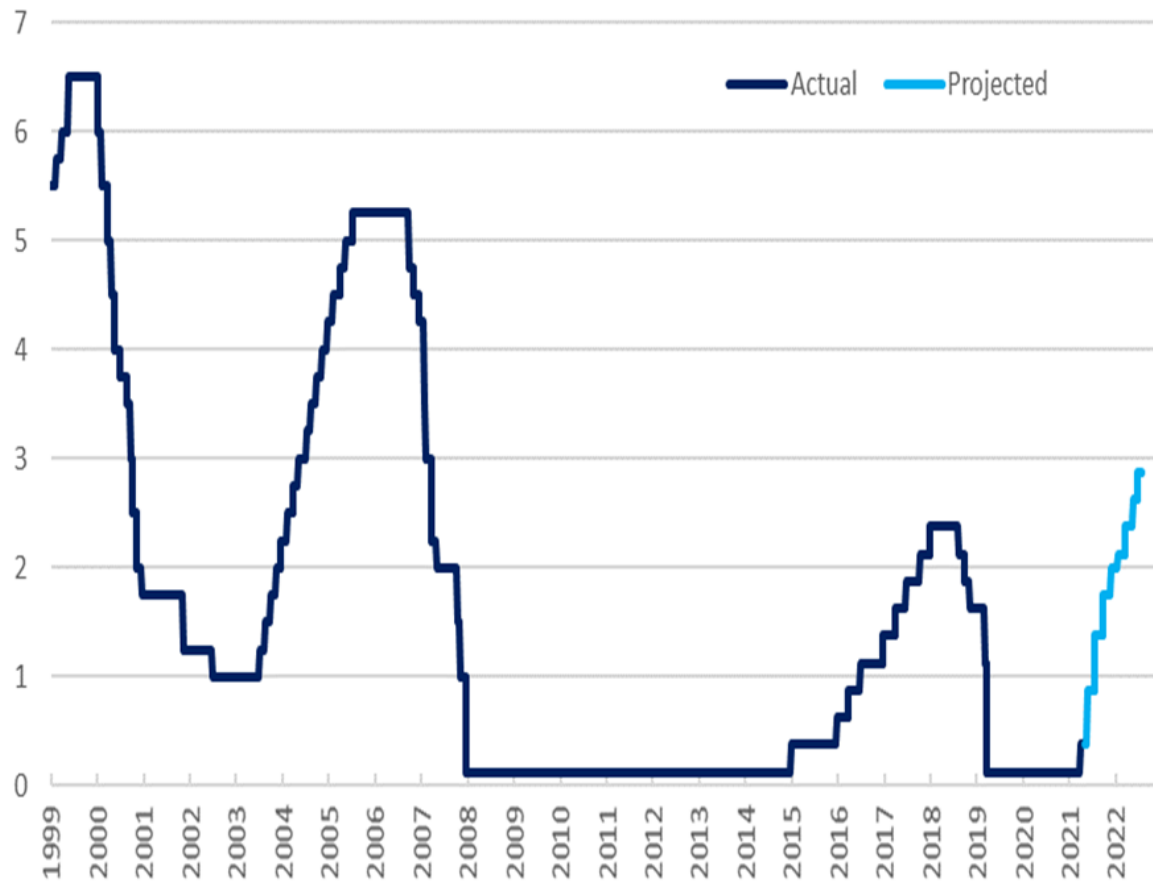
Source: BEA, The Conference Board



The Fed and US Monetary Policy

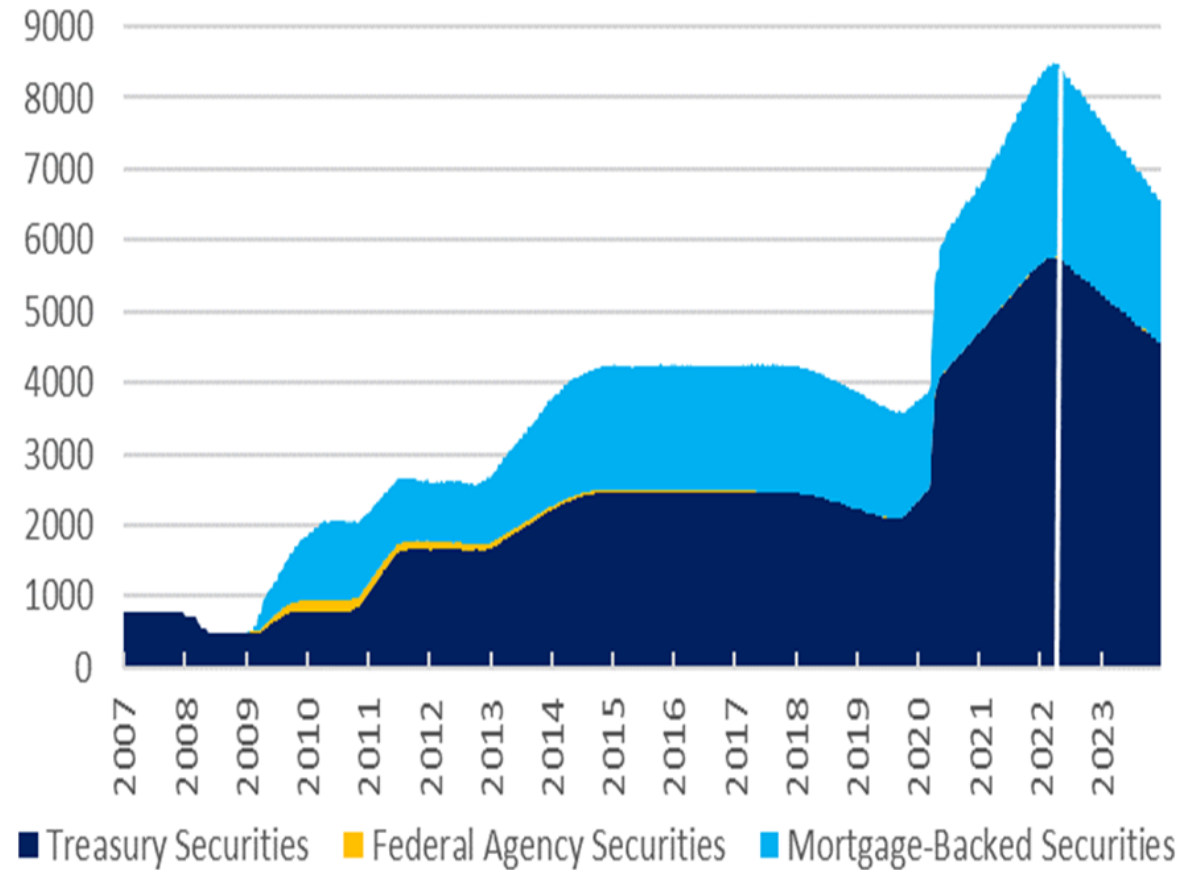
US Monetary Policy Expectations

US: Federal Funds Rate Target (Midpoint of Range, %)



Sources: Federal Reserve Board and The Conference Board.

United States - Fed Balance Sheet: Assets (Bil. US\$)



Sources: Federal Reserve Board and The Conference Board.



Higher Inflation Drivers – Price Spirals

Various Types of Price Spirals

Wage-Wage Spiral

- “wages rise because other wages are rising”

Price-Price Spiral

- “prices rise because other prices are rising”

- *Paul Krugman*

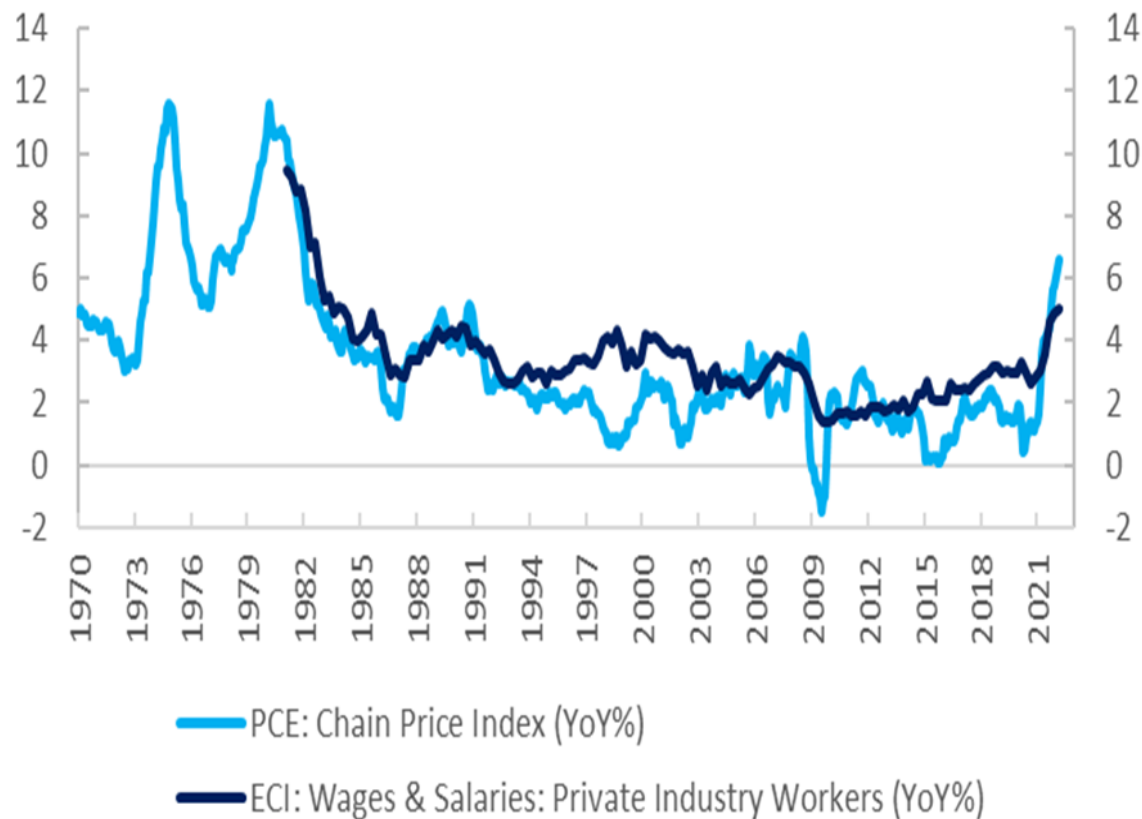
Wage-Price Spiral

- “workers want to maintain or increase their real wage, and firms want to maintain or increase their markups, and remains so long as either the initial trigger disappears or one side gives up”

- *Olivier Blanchard*

Is the US in a Wage-Price Spiral?

Wage vs. Consumer Price (Year-on-Year Percent Changes)

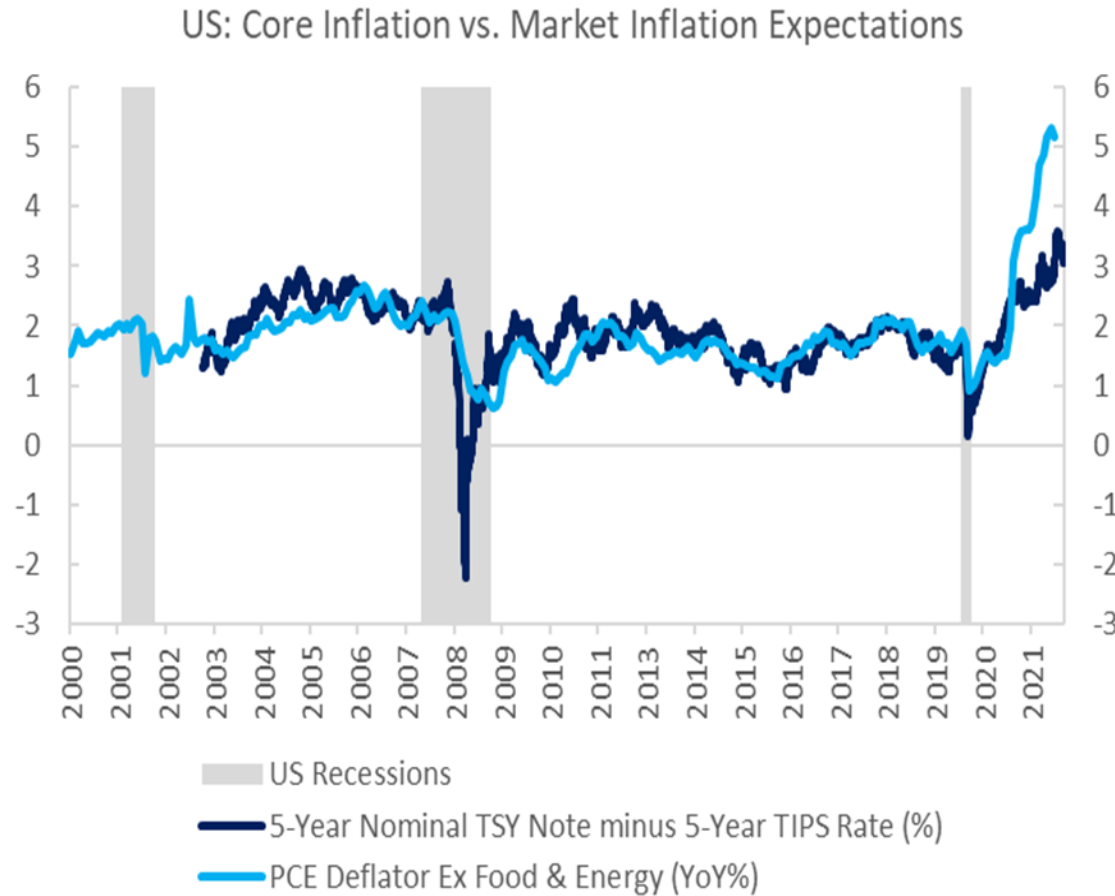


Sources: Bureau of Labor Statistics, Congressional Budget Office, and The Conference Board.



US Inflation Expectations

Market Inflation Expectations



Sources: Bureau of Economic Analysis, Federal Reserve Board, NBER, and The Conference Board.

Consumer Inflation Expectations



Sources: NBER, and The Conference Board.



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