Can We Bank on the U.S. Economy Avoiding Recession?

David P. Teolis

Former Deputy Chief Economist, International Markets, FX & Commodities

General Motors Company

Economic Backdrop

We are in a late-stage expansion of the business cycle, supported by still-resilient consumer spending; although excess savings are nearly depleted

The Good

- Supply chains returning to normal
- While job opportunities are slowing, the number of job openings exceeds the number of unemployed workers
- No financial contagion from banking crisis, so far

The Not So Good

- While overall CPI inflation is falling, core inflation is sticky, holding above the Fed’s 2% target
- A more restrictive monetary policy may be needed to slow growth below potential (~1.8%)
- Fitch downgrades U.S. sovereign credit rating

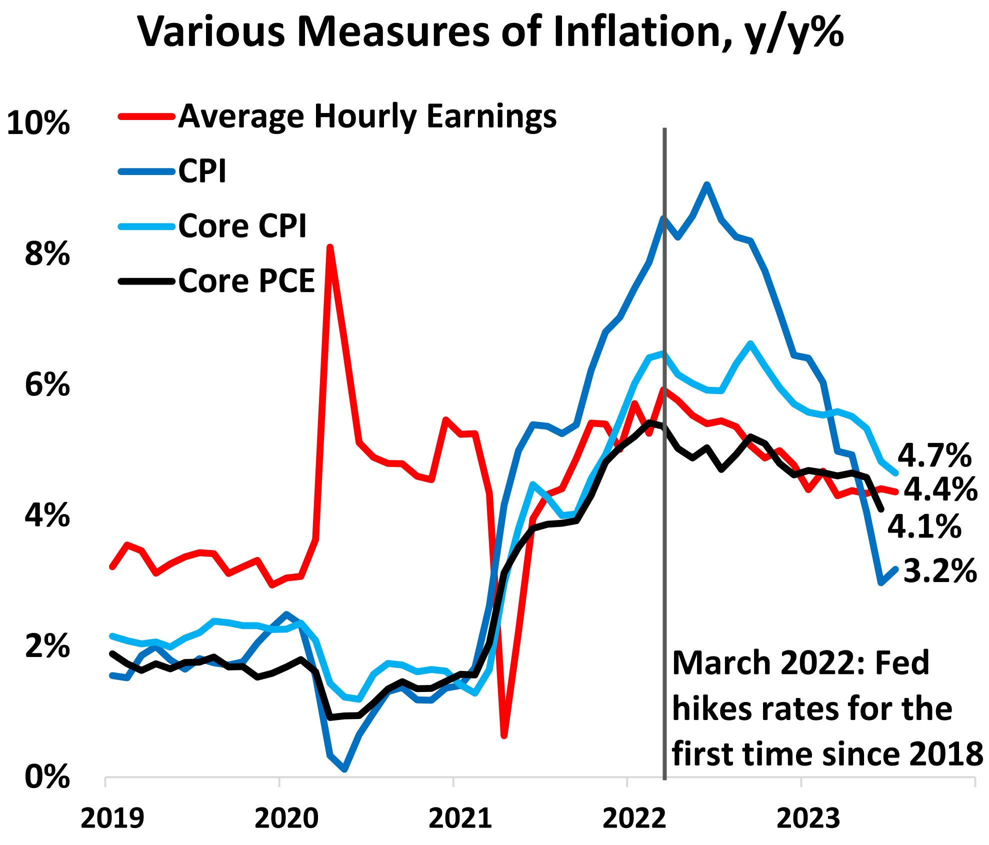
The Bad

- Yield curve has been inverted for more than a year, signaling recession
- Rising geopolitical tensions and geoeconomic risks; global monetary policy tightening adds to downside growth risks

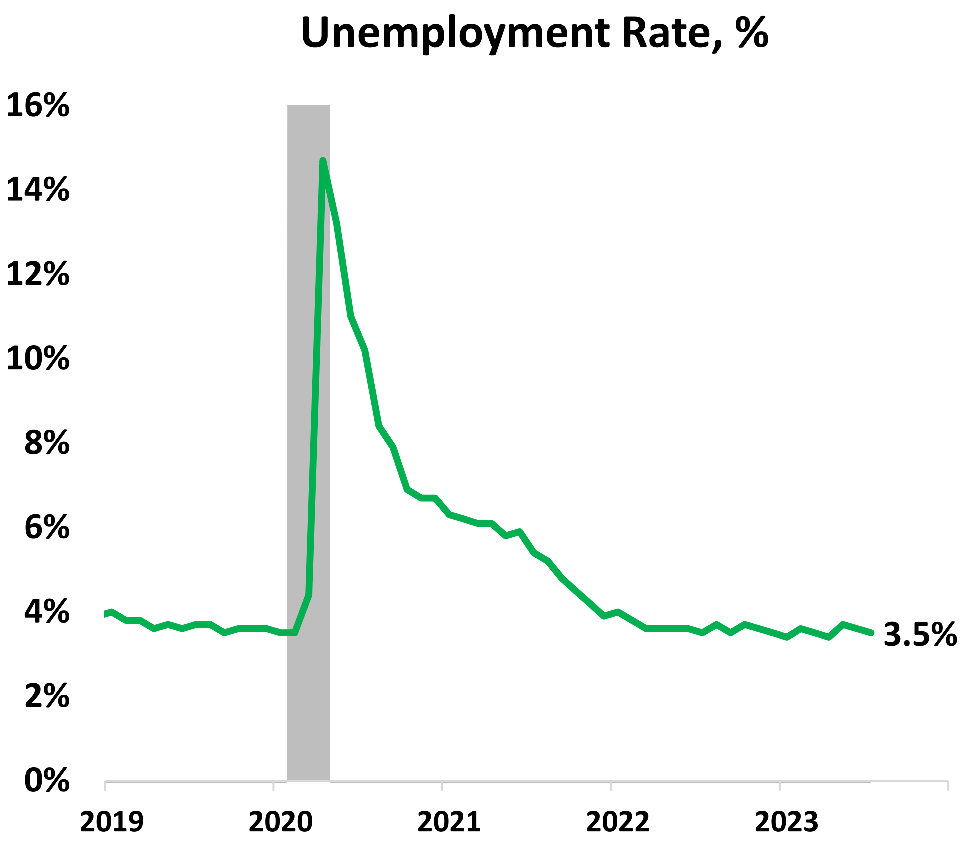
Can we avoid recession and achieve a soft landing?

Lower inflation, especially CPI, has been achieved with limited economic costs

However, core inflation has not slowed in a meaningful way



Sources: Bureau of Labor Statistics, Bureau of Economic Analysis, Haver Analytics

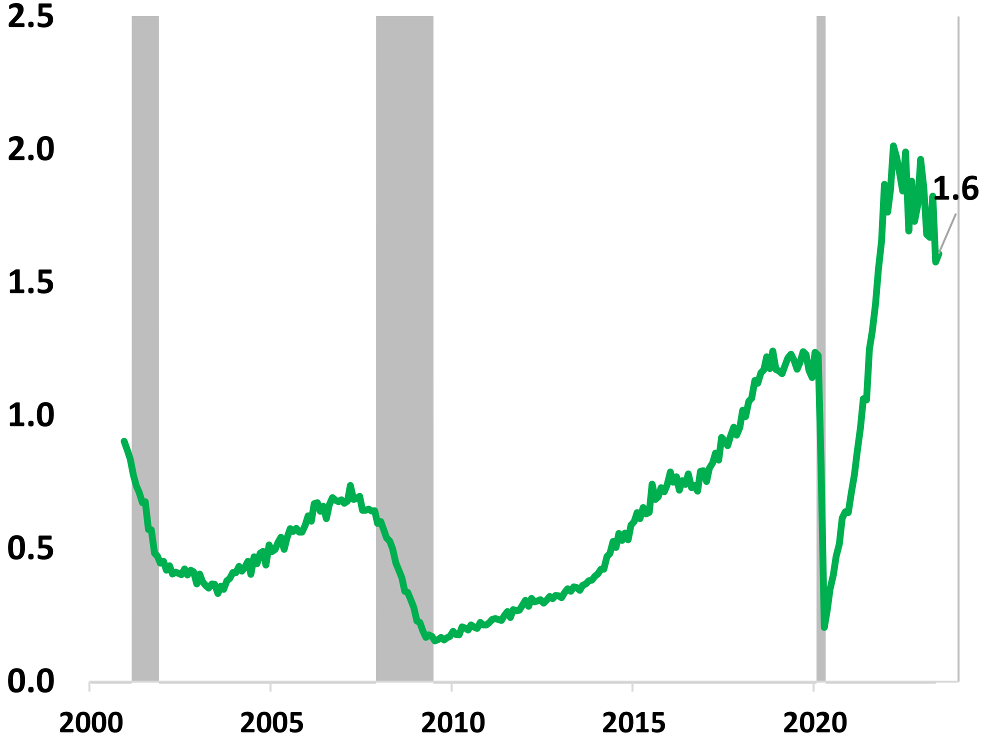


Sources: Bureau of Labor Statistics, Haver Analytics

But will the Fed's continuing effort to lower core inflation impose a higher economic cost?

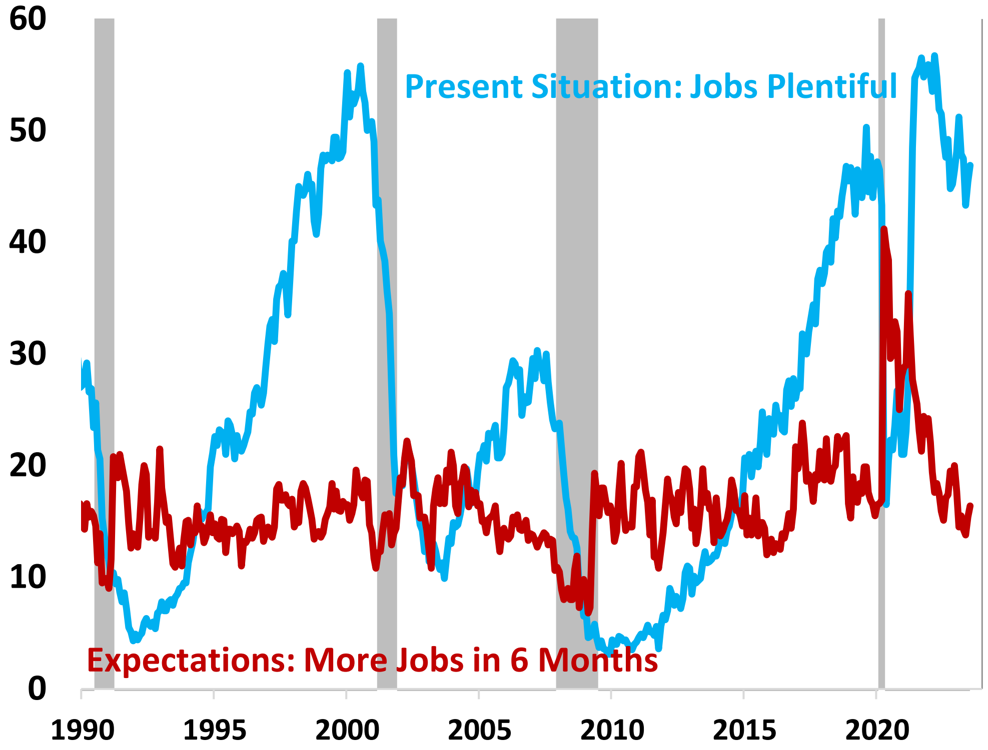
While the number of job openings exceeds the number of unemployed workers, employment opportunities are shrinking, reflecting early signs of labor market weakness

Job Openings Per Unemployed Worker



Sources: Bureau of Labor Statistics, Haver Analytics; Calculations: Author

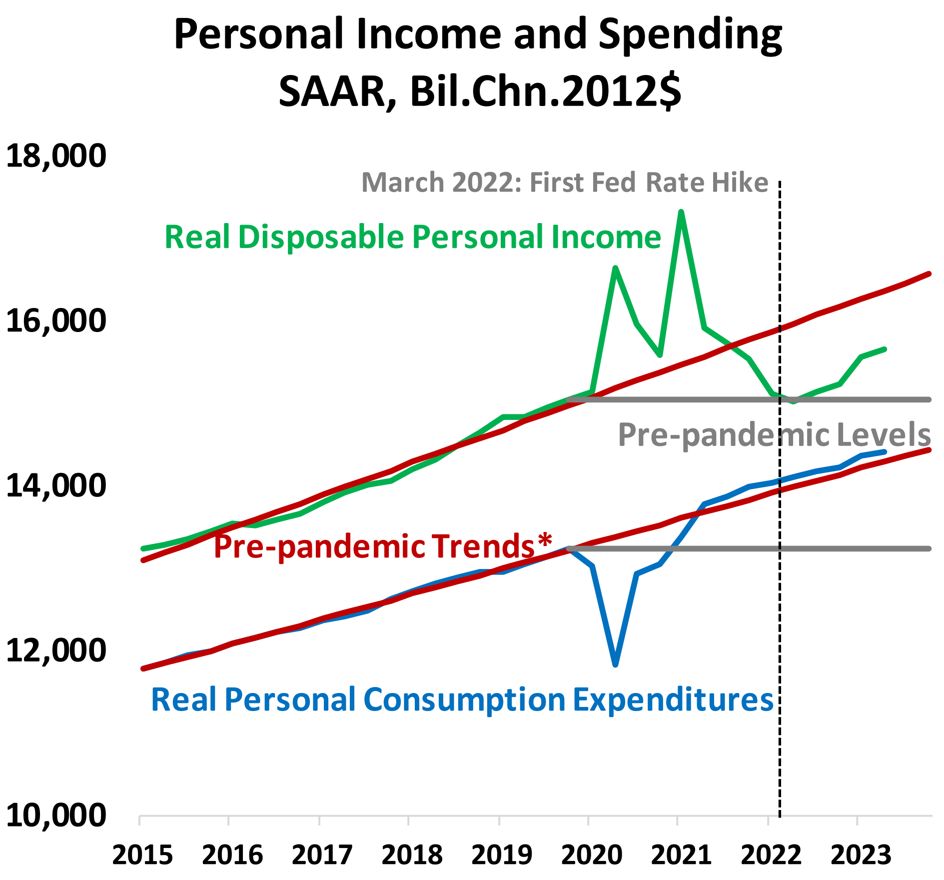
Consumer Confidence: Present versus Expected Jobs
% Respondents, Seasonally Adjusted



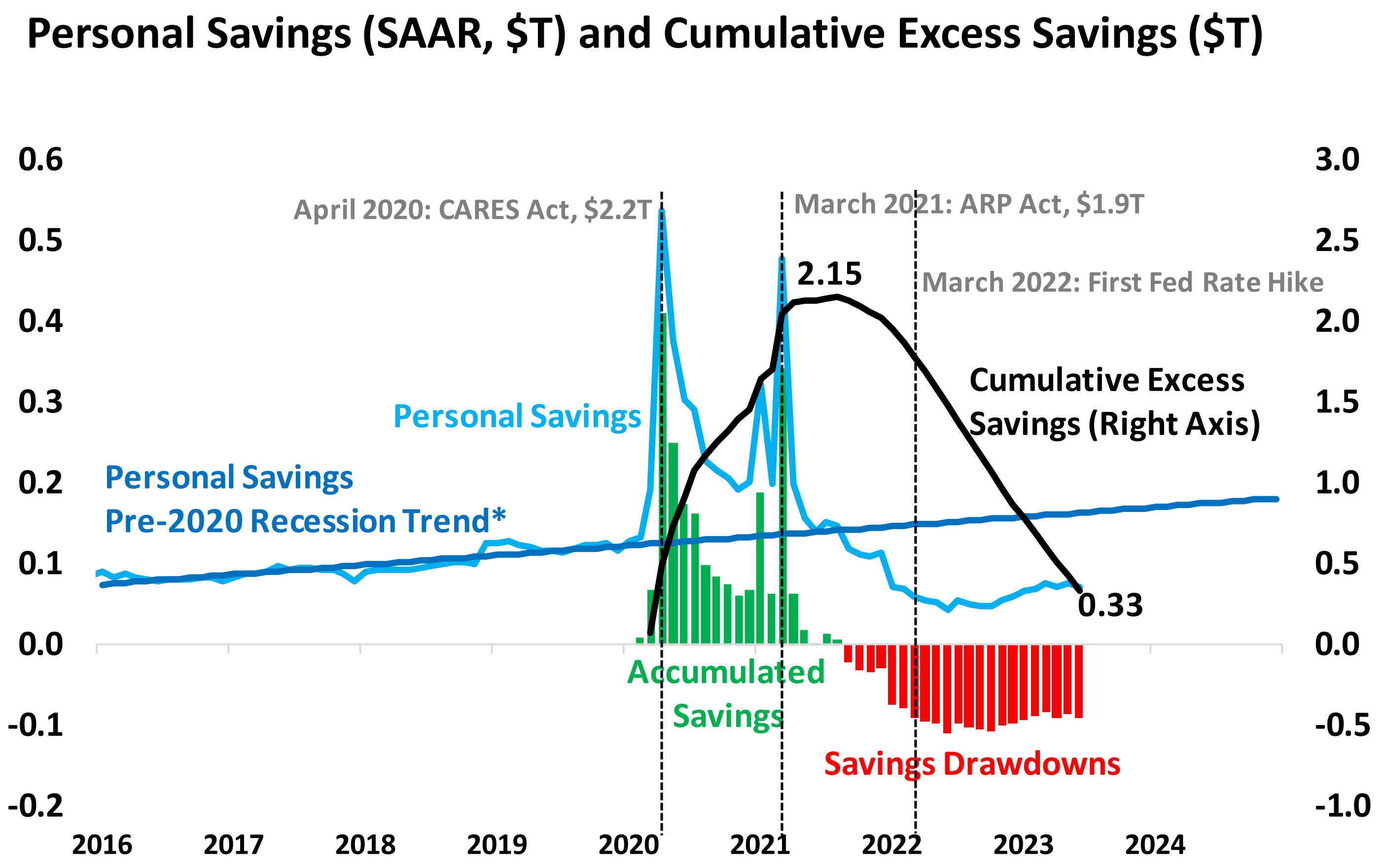
Sources: The Conference Board, Haver Analytics

Savings and low borrowing costs have been supporting spending, but this is not expected to last

Demand could fall due to reduced bank lending, weak real income growth, and depletion of excess savings as well as slowing job growth



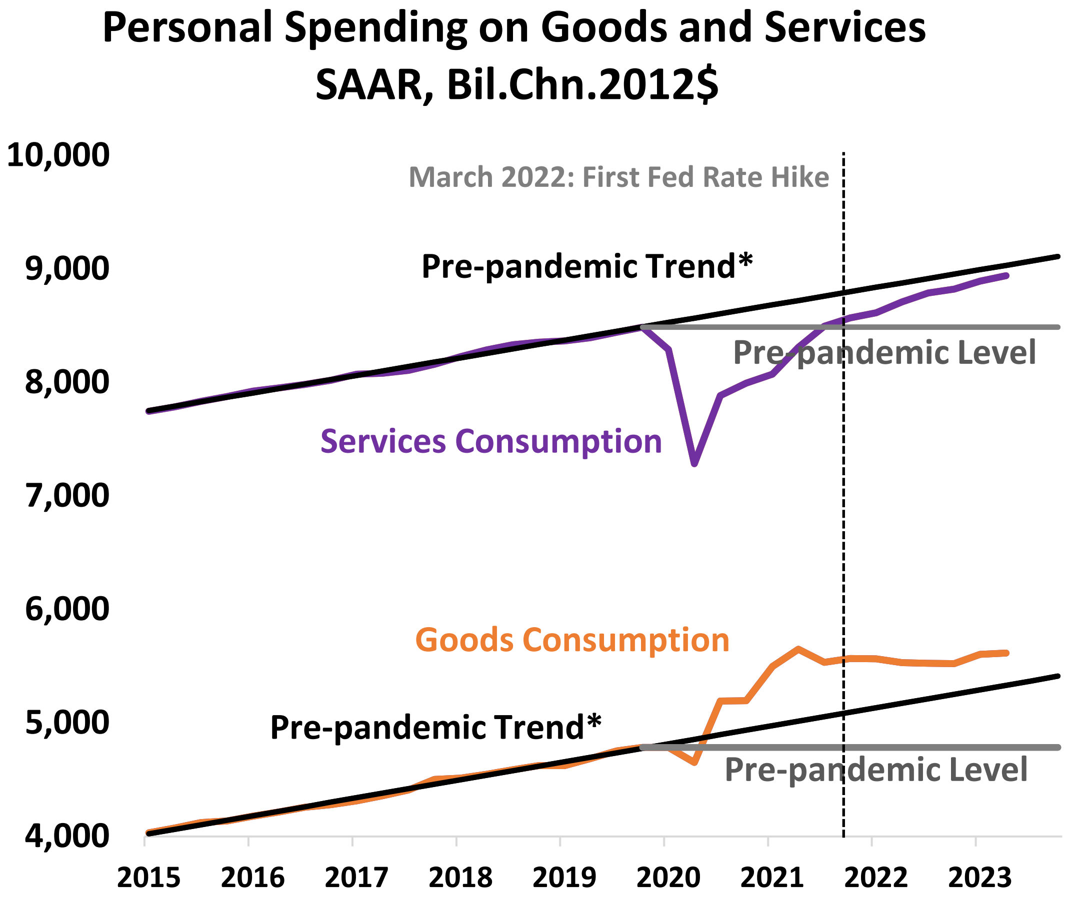
*Trend calculation based on the period 2015Q1 through 2019Q4.
Sources: Bureau of Economic Analysis, Haver Analytics; Calculations: Author



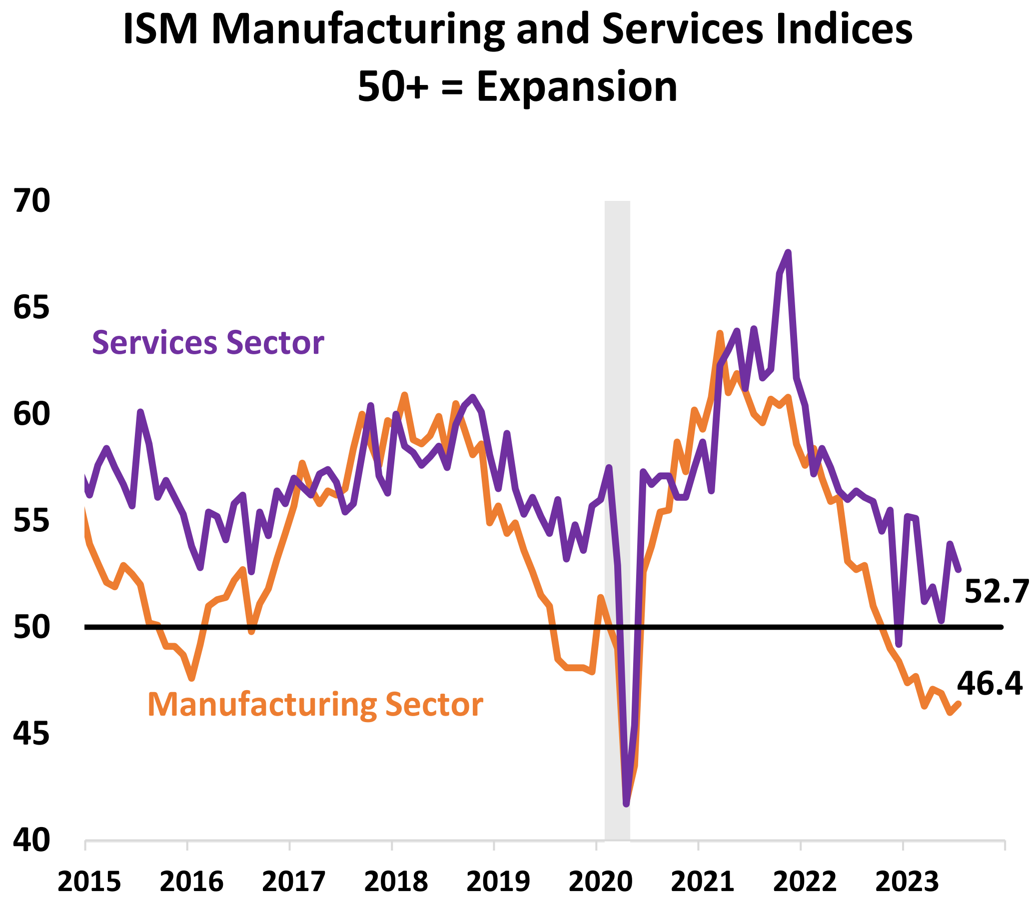
*Trend calculation based on the period January 2016 through January 2020.
Note: Cumulative savings is calculated as the difference between de-annualized actual savings and trend savings.
Sources: Bureau of Economic Analysis, Haver Analytics; Calculations: Author

As goods spending slowed, manufacturing sector entered recession

Services sector is marginally expanding on the back of rising spending on food services, accommodations, and transportation



**Trend calculation based on the period 2015Q1 through 2019Q4.*
Sources: Bureau of Economic Analysis, Haver Analytics; Calculations: Author

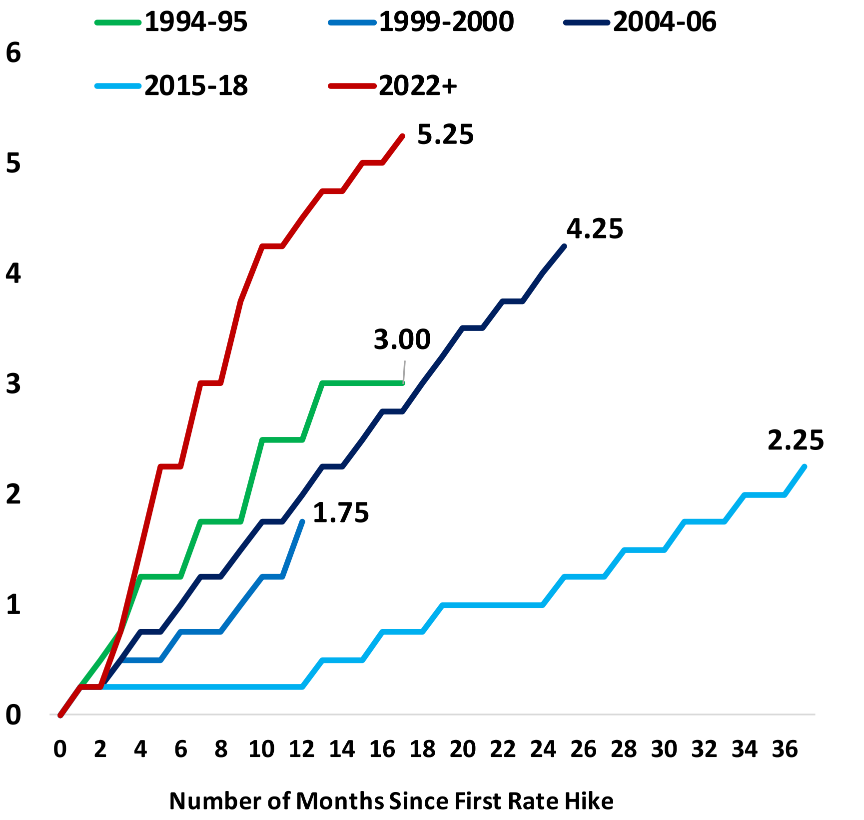


Sources: Institute for Supply Management, Haver Analytics

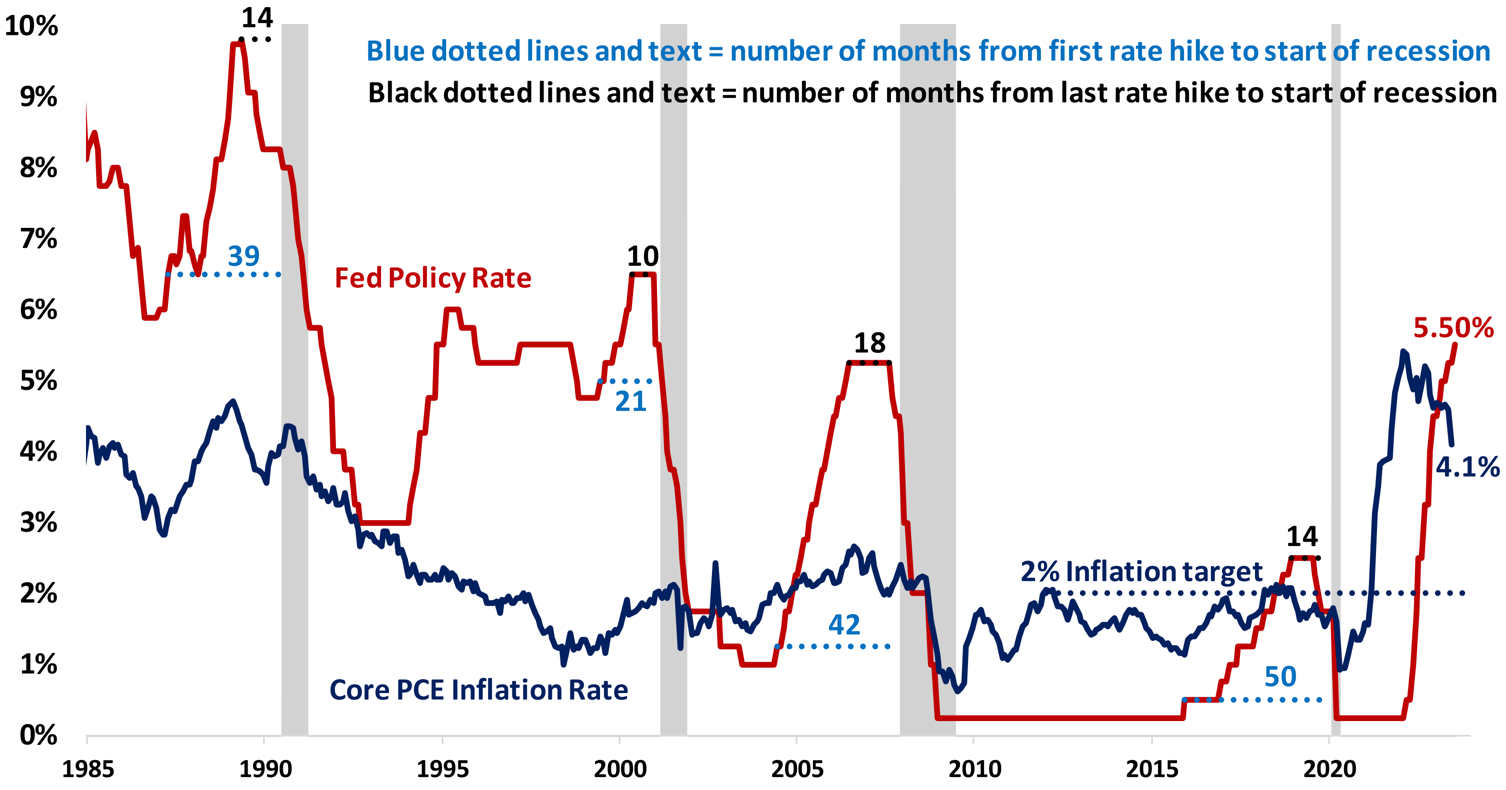
"…we will take into account the cumulative tightening of monetary policy and the lags with which monetary policy affects economic activity and inflation."

Transcript of Chair Powell's Press Conference November 2, 2022

Cumulative Increase in Rate Hikes During Tightening Cycles, Percentage Points



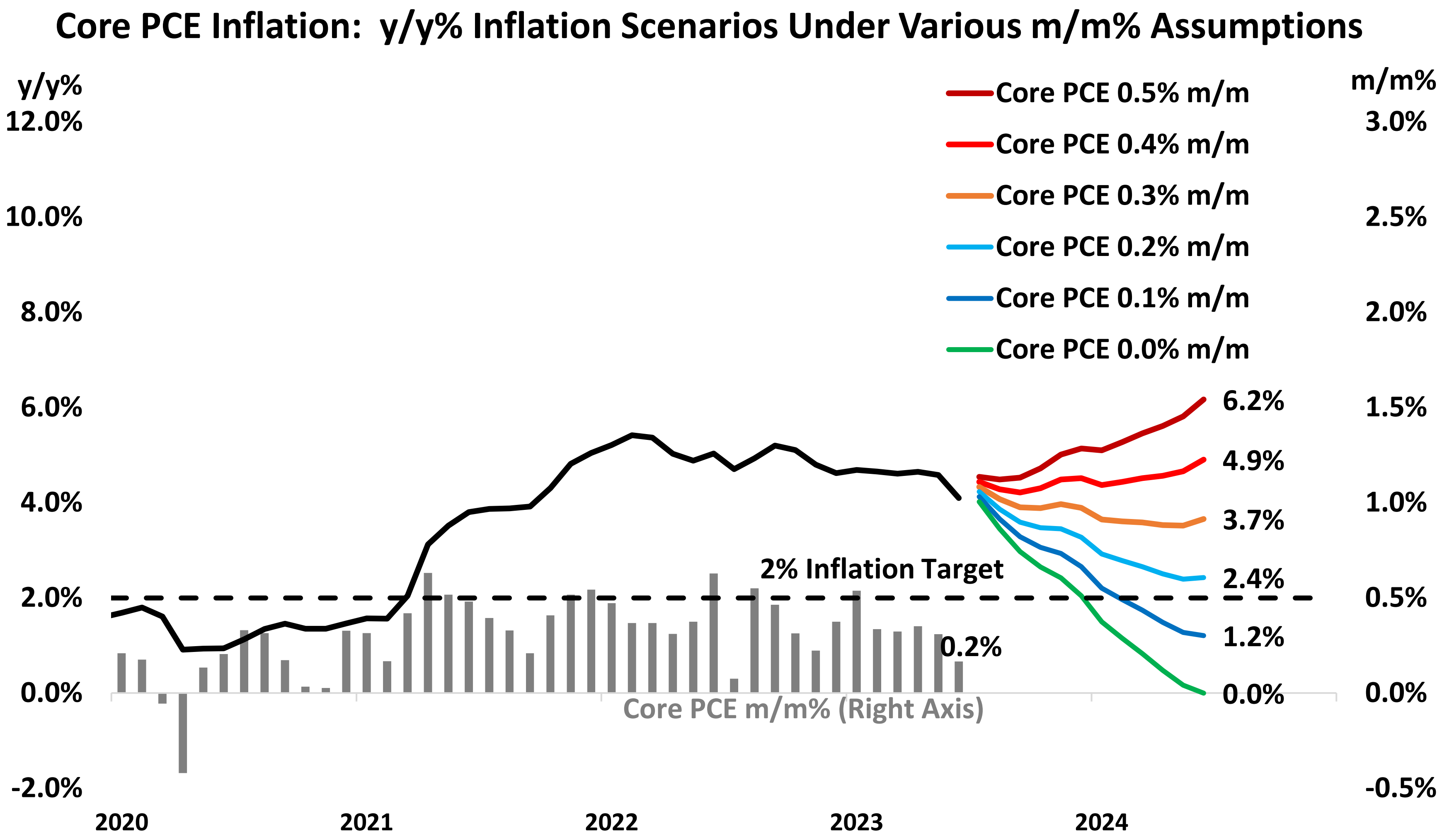
Fed Policy Rate (%) and Core PCE Inflation (y/y%)



"With inflation still well above the Committee's longer-run goal and the labor market remaining tight, most participants continued to see significant upside risks to inflation, which could require further tightening of monetary policy." – July 2023 FOMC meeting minutes

Sources: Federal Reserve Board, Bureau of Economic Analysis, Haver Analytics; Calculations: Author

We need m/m% core PCE inflation to slow to less than 0.2% to reach the Fed's 2% target



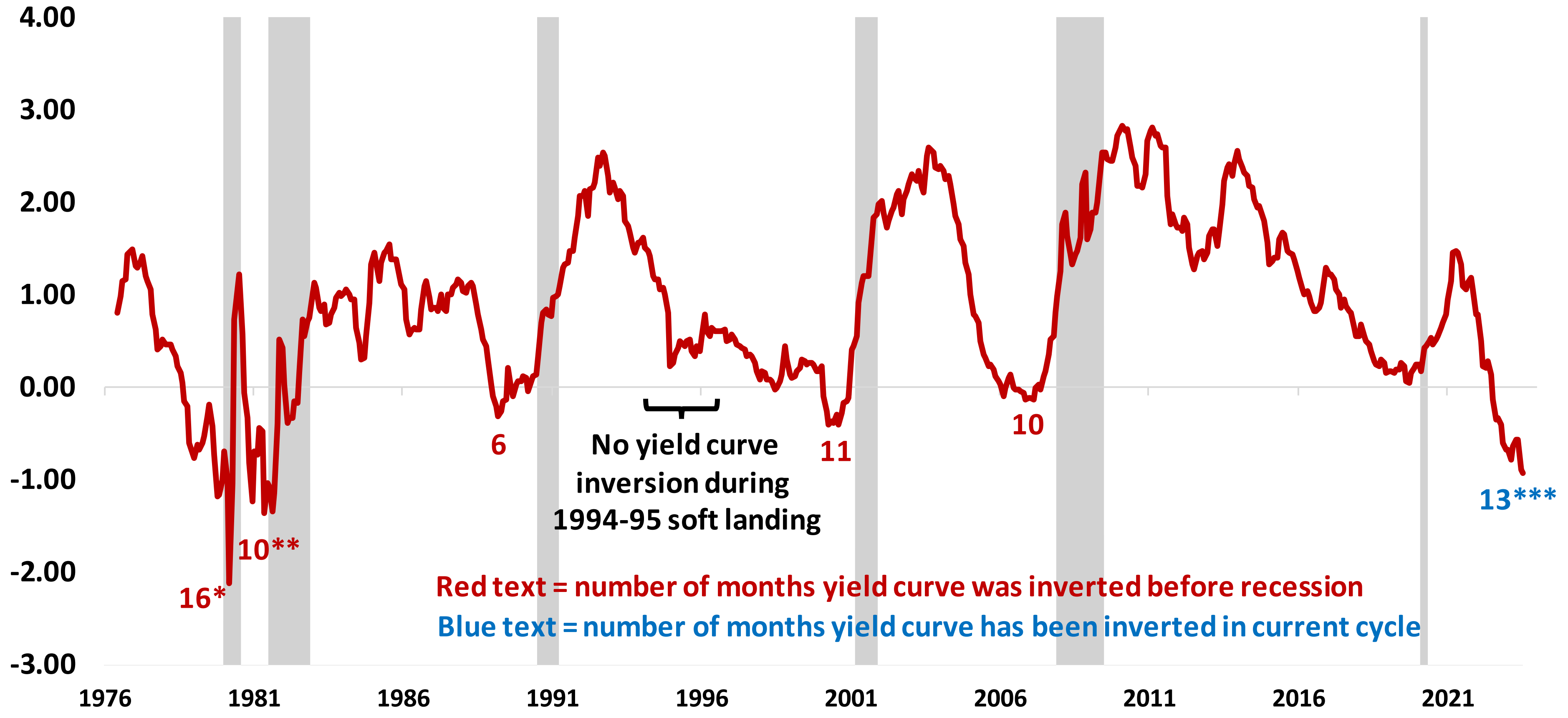
Sources: Bureau of Economic Analysis, Haver Analytics; Calculations: Author

"All [FOMC] members affirmed that they are strongly committed to returning inflation to their 2 percent objective."

July 2023 FOMC meeting minutes

Yield Curve is signaling recession risk

Yield Curve: 10-Year Treasury Bond Yield Minus 2-Year U.S. Treasury Note Yield, Basis Points/100



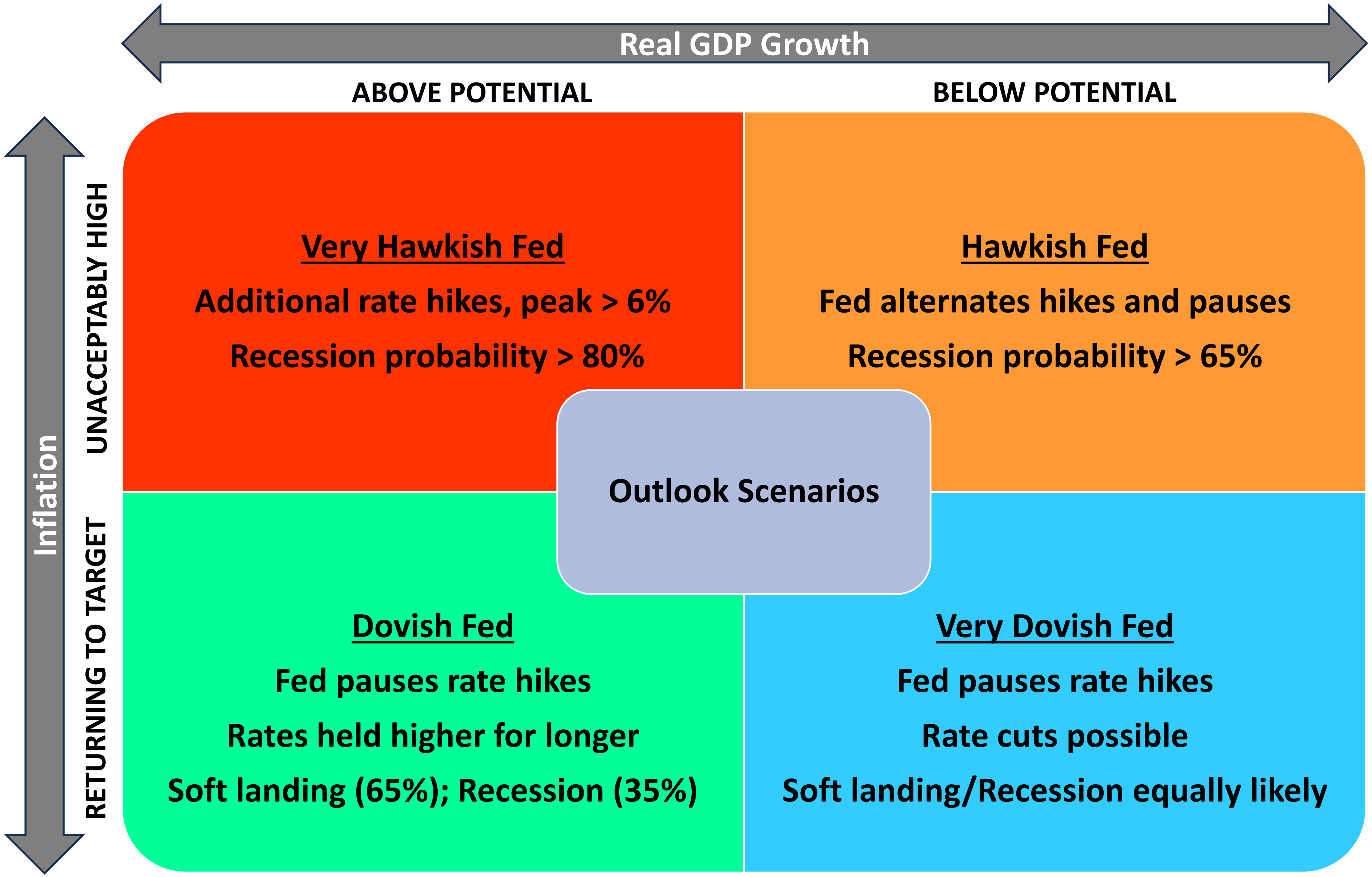
**Yield curve was inverted for 4 months during 1980 recession for a total 20 month of inversion.*

***Yield curve was inverted for 4 months during 1981-82 recession for a total 14 month of inversion.*

****Yield curve has been inverted for 13 months through July 2023, the longest inversion since the period prior to the 1980 recession and the deepest inversion since the period prior to the 1981-82 recession.*

Sources: Federal Reserve Board, Haver Analytics; Calculations: Author

Can recession be avoided in 2024?



What to watch for over the next six months

Key Indicators

- Monthly core inflation reading (m/m%)
- Real Fed policy rate: even if the nominal Fed policy rate is kept steady, lower inflation could result in passive monetary tightening which could dampen economic activity
- Unemployment rate: labor market weakens on restrictive monetary policy and tighter credit conditions
- Consumer spending and attitudes/confidence; depletion of pandemic excess savings
- Manufacturing and services trends: synchronizing or diverging; rolling versus synchronized sector recessions

Risks

- Positive: supply chain resiliency (reshoring/nearshoring), IT, green technologies, still-elevated home prices (providing positive wealth effect)
- Negative: rising energy prices, lower equity prices, restart of student loan payments, deteriorating housing/new vehicle affordability, UAW strike, global economics