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ECONOMIC OUTLOOK

MICHELLE GREEN
Principal Economist
Prevedere

U.S. Economic Outlook Report: Unpacking the Latest Economic Data

Prevedere Principal Economist, Michelle Green, provides a personal view on topical economic issues

Global risks continue to persist in May, placing the U.S. economy in a precarious position. Principal Economist Michelle Green analyzes recently released data in this economic outlook report, such as Q1 Real GDP, the April employment report, and increased interest rates.

Q1 Real GDP: What do the latest numbers mean for economic recovery?

Q1 Real GDP came out at the end of April, and it wasn't a surprise to see that GDP slowed in the first quarter of the year. Most economists expected a slowdown, especially coming out of the robust growth the U.S. economy experienced in 2021. However, the GDP release also revealed some remarkable strength in the domestic economy.

Most of the decline in Real GDP in Q1 was driven primarily by global forces and net exports. In other words, there was an incredible rise in imports that drove down the overall production number in the U.S., which somewhat masks the strength that emerged in domestic economic activities. While there was a decline in exports and inventories stemming from global forces, there was also some remarkable strength domestically in consumer spending and fixed investment. Given the extreme inflationary environment of Q1, the magnitude of spending, particularly for services, was more upbeat than many economists had been expecting.

Overall, despite the decline in Real GDP, the underlying data revealed some unexpected economic strength in the domestic economy. As encouraging as this is, it would be remiss not to acknowledge that there are still many risks to the economic recovery this year, particularly from shifting global forces. Inflationary pressure is likely to persist both in terms of magnitude and duration, stemming not only from factors relating to global supply chains, the war in Ukraine, and the continued lockdowns in China but also from some of the more structural forces in the U.S. economy today. As price pressure continues to build from overheating labor markets, housing and higher costs of services, the risks to economic recovery tilt to the downside.

Shifting Monetary Policy in the Next Quarter

Another major headline is that the Fed increased rates by 50 basis points, the latest sign of a significant shift in monetary policy. The majority of the economic community anticipated this both in terms of the increase and the timing. In the coming months, the Fed will likely continue with several more rate hikes in an attempt to reign in the inflationary pressures. However, the Fed may find that they are a bit behind the curve and should have started taking action sooner. The delayed timing is certainly of concern, and as financial conditions tighten, there is some risk that they may not achieve a slowdown in inflation without aggravating recessionary risks.

April Jobs Report Shows Decrease in Labor Force Participation

According to the April employment report, the U.S. economy added slightly more jobs than expected amid an increasingly tight labor market. Given the high inflationary environment, many economists projected a slight acceleration in labor force participation in response to an improving COVID situation and tightening household budgets. In actuality, the opposite occurred, and labor force participation rate dropped from 62.4% to 62.2%. This is a signal that worker reluctance to re-enter the labor force remains a significant driver of labor shortages, even in the face of rising costs, which is likely to put continued pressure on wages for key industries struggling to find and retain essential workers.

As a result, the unemployment rate held steady at 3.6% when many economists projected it would fall to 3.5%. This makes sense in the context of a worker-driven shift labor flows, as we've seen over the last couple of years. The U.S. has seen quit rates in many industries accelerate to near all-time highs, adding to increased bargaining power for labor to obtain both higher wages and greater benefits. This is expected to continue throughout the year but may be softened as the Fed embarks on its current path of quantitative tightening. The Fed hopes that by raising interest rates, they will engineer a soft landing by eliminating some of the job openings or slowing down the rate without causing a meaningful increase in unemployment. The next few months will depend on how willing workers are to re-enter the labor force. As of now, it's unlikely that the U.S. will see a meaningful rise in the labor force participation rate while wages continue to rise and keep up with worker demands.

Navigating the Economic Uncertainty Ahead

Given the volatility we're seeing in the data today, the most important and most valuable thing you can do for your business is to pay attention to how your core consumers respond to these uncertain times. Here at Prevedere, we help our clients do that through scenario planning and evaluating a range of economic outcomes. As unprecedented uncertainty and global market forces persist, it's more important than ever that business leaders stay vigilant in planning for various outcomes.