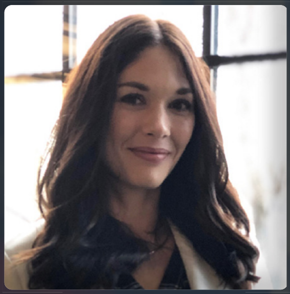

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provides a personal view on
topical economic issues

Economic Outlook: Consumer spending points to growing recessionary risk in late 2022 and into 2023

The state of the U.S. economy in summer 2022 is one of great complexity and uncertainty. As economic indicators and media narratives seem to send conflicting messages, many business leaders are finding it increasingly challenging to identify definitive answers as they conduct their forecasting and business planning for the rest of 2022 and into 2023.

Our economist team has analyzed the status of the U.S. economy and developed a baseline projection to provide high-level insights to executives who are leading U.S. businesses through this singular market, with a particular eye on the health of the consumer.

Consumer behavior points to continued recessionary environment into 2023

The first half of 2022 saw two consecutive quarters of shrinking GDP in the U.S. economy, and greater challenges still lie ahead. The recession probability towards the end of 2022 and into 2023 remains elevated as households begin to feel the full effects of inflation and tightening monetary policy.

Consumer spending represents the largest portion of GDP in the U.S., historically about 70%; therefore, a decline in spending can pose a significant risk for the economy. The combination of government stimulus and rising wages over the past two years kept demand strong during a period of recovery. However, there are now numerous warning signs in the data that suggest that spending is at risk of stagnating or even slowing down.

Inflation is outpacing wage growth

Wage growth is no longer keeping pace with inflation. While nominal wage growth has remained elevated during this recent inflationary period, real wage growth has declined to its lowest level since the beginning of the pandemic.

According to a recent survey conducted by CNBC, two-thirds (66%) of American workers feel that their salaries are not keeping pace with inflation. This presents a risk to consumer spending as the ability to support current levels of spending is eroded.

Saving is down. Debt is up.

Excess savings helped keep the consumer healthy as the U.S. returned to a state of normalcy in the post-Covid era, and overall spending stayed high enough to support economic recovery throughout the last year. However, those savings have seemingly run out, and consumers' financial cushions are largely depleted.

As a result, the personal savings rate showed a year-over-year decline of almost 50% in June 2022, while credit card spending has increased by nearly 16% relative to its pre-pandemic level. This is concerning given that the cost of borrowing is expected to rise further due to rate hikes by the Fed through the end of the year.

Consumer sentiment shows pessimism

With household finances under renewed strain, it is not surprising that consumer sentiment has tumbled to a historic low. Reflecting that pessimism, 31% of consumers have reported that they will be reducing their spending in the second half of this year as their economic situation deteriorates. Additionally, 36% of consumers expect to be laid off in response to a slowing economy.

Despite July's strong employment report, the above signs do indicate that the probability of a recession by the end of this year is high. Business leaders should take note of these indicators and warning signs so they can adequately prepare their businesses for a recession, even if the NBER has not yet declared it.

What happens next?

So, what happens next? What are the realistic expectations for the economy in the next 6-8 months?

In looking across all economic indicators, the data suggests that economic activity should be able to withstand some level of initial tightening. However, business leaders should keep in mind that, despite today's signs of resilience, it is essential to keep an eye on the future to stay ahead of the curve.

Even though official data might not yet show a broad-based slowdown, the likelihood of one occurring towards the end of 2022 and into 2023 remains quite high. It is important to note, though, that recessions are not all the same. With the positive signs of falling gas prices, easing supply chain tensions, and continued strength in the labor market, there is reason to be confident that if the U.S. economy enters a recession, it will be relatively mild.

Thank you

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