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# The U.S. Economic Outlook for 2022–2023
# Executive Summary: February 2022

***Pandemic Ending?***

*The Omicron strain of the coronavirus swept quickly through United States. While many hospitals were challenged, private precautions look to have been sufficient to maintain orderly functioning of the healthcare system. In the aftermath of Omicron, and largely responding to changing public sentiment, several states have already scrapped many COVID-19-related restrictions, and many others will likely follow soon. Short of the emergence of new strains that cause severe disease in those with prior immunity, we expect the pandemic's impact on the economy largely to have waned by mid-2022.*

*Economic growth rebounded strongly in 2021, averaging 5.7 percent for the year. Economic growth ended 2021 with a bang, registering a 6.9 percent pace of real growth in the fourth quarter, but the bulk of the headline print was due to an unexpectedly large bounce in inventory restocking.*

*Despite widespread expectations of a considerable hit to job creation due to the wave of Omicron infections, January payroll job gains came in at 467,000 jobs, broadly in line with the prior trend. The household survey appears to have been less upbeat, but the unemployment rate barely ticked up to 4.0 percent. Employers chose to retain more than 3.6 million workers who were out sick with Omicron. We expect these worker absences to have a modest impact on economic output in the current quarter.*

***Not Our Favorite 1980s Flashback***

*January was the eighth time in the last twelve months the annualized rate of CPI inflation surpassed 7 percent. As a result, the all-item index rose by 7.5 percent year-over-year in January, the largest 12-month increase since the period ending February 1982. Massive pandemic-related shocks to preferences, disruptions of production and distribution networks, and unprecedented policy responses have combined to push inflation to 40-year highs. Near-term inflation is likely to remain elevated, but we see some hopeful signs that a slowdown later in 2022 may be in the cards. Rent increases for new tenants, used vehicle price inflation, and several key producer price inflation measures may have already peaked or appear likely to peak very soon.*

***Schizophrenic Consumers***

*The disconnect between consumer sentiment and expenditures deepens. Early in 2022, the University of Michigan's Index of Consumer Sentiment plunged to new pandemic lows, reaching a level more consistent with a severe recession. In the meantime, light vehicle sales and overall retail sales rebounded strongly. Swollen checking/savings account balances due to government stimulus and the household spending cutbacks earlier in the pandemic have facilitated continued growth of consumption expenditures. However, as inflation eats away at those savings and reduces real wages, consumer behavior may trend toward the historical relationship between sentiment and spending.*

***The Dawn of Expensive Mortgages***

*House prices have appreciated at a remarkably strong pace since the summer of 2020, with recent year-over-year increases in the 18–20 percent range. Low mortgage rates, a shortage of homes for sale, high saving rates, government support programs, and increased demand for space due to the pandemic have likely all contributed to the surge in house prices. For now, homes remain reasonably affordable for those who can get a mortgage, because still-low mortgage rates compensate for high prices. However, our projection for a significant increase in mortgage rates suggests that purchase affordability will deteriorate substantially over the next two years, exerting downward pressure on demand.*

***High Trust in the Fed***

*Inflation expectations are important for price dynamics and for monetary policy transmission. Despite the alarming trend of recent inflation, the 5-year breakeven inflation rate and long-term inflation expectations from UM's Survey of Consumers have remained reasonably anchored in recent months, suggesting that economic agents have high confidence in the Fed's ability to tame inflation.*

*With inflation surpassing the Fed's long-term 2 percent target manyfold, only a sudden deterioration of the labor market could deter the Fed from a swift tightening of monetary policy. Consistent with our inflation and* *labor market outlooks, we expect the Fed to start increasing the target federal funds rate range very soon and to keep raising rates swiftly during 2022, before moderating the pace in 2023. The target fed funds rate range reaches 1.5–1.75 percent by the end of this year and 2.25–2.5 percent by the end of 2023.*

***ZomBBBie***

*Inflation appears to have killed the Build Back Better bill for now. However, we anticipate parts of the agenda to be exhumed and reanimated by spring. We expect a reconciliation package, comprising lean cuts of vital BBB parts—the child tax credits, ACA credits, some climate-related provisions, and a limited return of the SALT deduction—at a 10-year price tag of approximately 700 billion dollars. The bill will likely have to reduce future deficits to have a chance at passing.*

*The debt ceiling has been raised for now, but it may come back with a vengeance depending on the outcome of the November elections.*

*Continued real GDP growth and elevated inflation will fuel strong growth in federal receipts. At the same time, a sizable cutback in expenditures appears likely. We anticipate the federal deficit to drop from 13.2 percent of GDP in fiscal 2021 to 3.3 percent in 2023.*

***The 2022–23 Outlook***

*We expect production disruptions due to the Omicron wave to constrain the pace of real GDP growth to 2.4 percent in the current quarter. In 2022Q2–Q3, strong service consumption growth, robust new home construction, and a rebound of spending on new vehicles help lift growth to a pace of 4.1 percent. By the end of 2022, real GDP will have caught up with the pre-pandemic growth trend. Calendar year GDP growth slows from 4.1 percent in 2022 to 2.8 percent in 2023.*

*As rents rise and some supply shortages prove challenging to resolve, year-over-year core CPI inflation reaches 6.3 percent in 2022Q1 before starting to moderate, averaging 5.5 percent in calendar 2022. As the Fed raises rates, supply chains stabilize, and demand cools down, core inflation slows to average 3.5 percent in calendar 2023. The all-item CPI inflation first outpaces core CPI in 2022, but then lags behind in 2023, largely driven by the oil price dynamics.*

*The pace of monthly payroll job gains gradually slows over the forecast, from 469,000 jobs per month in 2022Q1 to 326,000 in 2022Q4 and to just 136,000 in 2023Q4. By the third quarter of 2022, the number of payroll jobs in the economy surpasses pre-pandemic levels.*

*The medium-term production outlook has improved. We expect that rebuilding of inventories will allow sales to reach a 16.2-million-unit pace by 2022Q4. Light vehicle sales total 15.5 million this year. In January 2022, the new vehicle CPI stood 12.2 percent above the reading a year ago. High prices delay the return of above-17-million sales beyond our current forecast horizon, with calendar 2023 sales totaling 16.7 million.*

*Despite material shortages, total housing starts increase by about 125,000 units in 2022, propped up by high prices. The pace of new home construction stabilizes in 2023 as housing price appreciation slows and mortgage rates top 4.5 percent.*

| | **Actual** | | **RSQE Forecast** | |
|---|---|---|---|---|
| | 2020 | 2021 | 2022 | 2023 |
| GDP (billions of current $) | 20893.7 | 22993.5 | 25248.8 | 26849.4 |
| Real GDP (billions of 2012 $) | 18384.7 | 19427.2 | 20217.9 | 20774.8 |
| % change: year-over-year | -3.4 | 5.7 | 4.1 | 2.8 |
| % change: 4th-qtr-to-4th-qtr | -2.3 | 5.5 | 3.4 | 2.2 |
| Nonfarm payroll employment (millions) | 142.1 | 146.1 | 151.8 | 155.0 |
| Civilian unemployment rate (%) | 8.1 | 5.4 | 3.5 | 3.1 |
| Capacity utilization, total industry (%) | 71.6 | 75.4 | 77.4 | 78.0 |
| Inflation (private nonfarm GDP deflator, % change) | 1.2 | 4.1 | 5.5 | 3.5 |
| Inflation (CPI-U, % change) | 1.2 | 4.7 | 6.1 | 3.2 |
| Inflation (core CPI, % change) | 1.7 | 3.6 | 5.5 | 3.5 |
| Light vehicle sales (millions) | 14.5 | 15.0 | 15.5 | 16.7 |
| Private housing starts (thousands) | 1396.6 | 1598.3 | 1726.6 | 1722.0 |
| 3-month Treasury bill rate (%) | 0.4 | 0.0 | 1.0 | 2.0 |
| 10-year Treasury note rate (%) | 0.9 | 1.4 | 2.1 | 2.5 |
| Conventional mortgage rate (%) | 3.1 | 3.0 | 3.8 | 4.2 |
| Real disposable income (billions of chained 2012 $) | 15676.2 | 16015.2 | 15390.0 | 15935.9 |
| % change | 6.2 | 2.2 | -3.9 | 3.5 |
| Corporate profits after tax (billions of current $) | 1908.4 | 2590.2 | 2588.9 | 2713.5 |
| Value of U.S. $ (FRB broad index), % appreciation | 1.7 | -3.9 | 1.7 | 0.0 |
| Current account balance (NIPA basis, billions of current $) | -587.1 | -831.0 | -872.2 | -749.7 |
| Federal surplus (FY, NIPA basis, billions of current $) | -2840.1 | -2949.6 | -1182.7 | -868.2 |