

Fed Tightening Will Be Harder, Faster, Stronger, and Worse for 2023's Growth Prospects

The economy downshifted in September but still performed better than expected. Nonfarm employment growth slowed to 263,000, the slowest since April 2021, though still faster than growth of the working population. The unemployment rate dipped back to July's half-century low. While job openings are coming down, they still outnumber jobseekers. Industrial production rose nicely, but will probably slow near-term since the benchmark manufacturing survey is at the lowest since the first half of 2020. And housing is correcting with 30-year mortgage rates around 7% and homebuyers' mortgage applications down to levels last seen in the early 2010s. Headwinds overseas are increasing, too, from recessions in Europe and China, as well as from the strongest dollar since the early 2000s.

Despite a cooling economy, inflation surprised to the upside again in September. While gasoline prices fell in the month, prices of food rose, and core CPI hit a new multi-decade high. Inflation will stay very bad for at least a few more months. Gasoline prices edged up again in the first half of October, and home heating costs will be higher this winter as Russia-Ukraine pushes up prices of natural gas, heating oil, and electricity. In 2023, inflation will continue to overshoot the Fed's 2% target, but by how much is harder to say. Prices of industrial and agricultural commodities have pulled back as the global economy has weakened, home prices are coming back down, and business surveys are reporting slower price increases; this should slow inflation. Leaning in the other direction, price increases have become more widespread over the last year in ways that could persist into 2023, like in accelerating increases of sticky prices of services provided by small businesses, including car repairs, daycare fees, and piano lessons.

Upside risks to inflation will keep the Fed on the warpath for a few more months. They are likely to make a fourth consecutive 0.75% interest rate hike in November, then a 0.50% hike in December and a 0.25% hike at the next decision in early February 2023. Aggressive rate increases will compound headwinds from housing, inflation eroding consumer spending power, and weak foreign economies, making a recession by the end of 2023 a two-in-three chance. If a recession happens, job losses and pullbacks in business and consumer sentiment will probably weaken wage growth and cool inflation by the second half of 2023, allowing the Fed to begin lowering interest rates.

Inflation and interest rates face both upside and downside risks. To the upside, the stickier inflation becomes, the longer it will persist in 2023, and the more the Fed will have to raise rates and squeeze the interest-rate sensitive parts of the economy, like housing, capex, and commercial real estate. To the downside, the economy might already be weakening more than expected, fueling a faster drop in businesses' pricing power, wage growth, and property values that could slow inflation faster than this forecast anticipates.

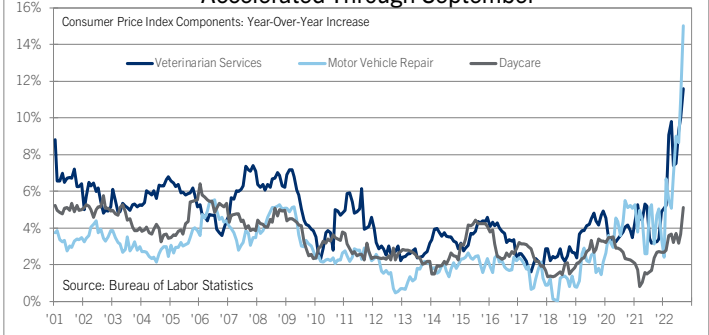
U.S. Economic Outlook, Summary

<i>a = actual f = forecast</i>	1Q'22a	2Q'22a	3Q'22p	4Q'22f	1Q'23f	2Q'23f	3Q'23f	2021a	2022f	2023f	2024f
Real GDP (Percent Change Annualized)	-1.6	-0.6	1.5	-1.6	-3.9	2.0	3.0	5.9	1.6	-0.3	2.0
CPI (Percent Change Year-over-Year)	8.0	8.6	8.2	7.8	6.7	4.7	4.0	4.7	8.2	4.6	1.9
Payroll Jobs (Average Monthly Diff., Ths.)	573	409	377	50	-333	50	175	514	352	18	146
Unemployment Rate (Percent)	3.8	3.6	3.6	3.8	4.2	4.4	4.5	5.4	3.7	4.4	4.1
Federal Funds Rate (Effective)	0.12	0.76	2.26	3.58	4.58	4.63	4.38	0.08	1.68	4.42	3.17
10-Yr. Treasury Rate	1.94	2.93	3.08	3.52	3.09	3.09	3.30	1.44	2.87	3.17	2.78
<i>a = actual p = preliminary f = forecast</i>											

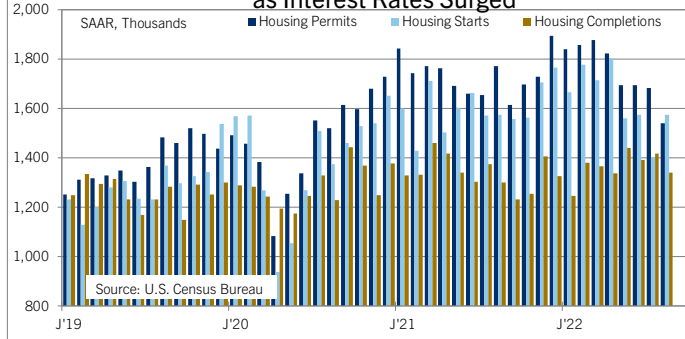
On the One Hand, Purchasing Managers Are Reporting a Big Pullback in Prices



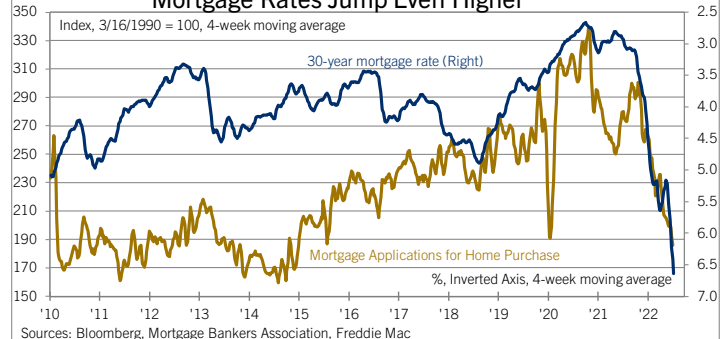
On the Other Hand, Inflation of Sticky Service Prices Accelerated Through September



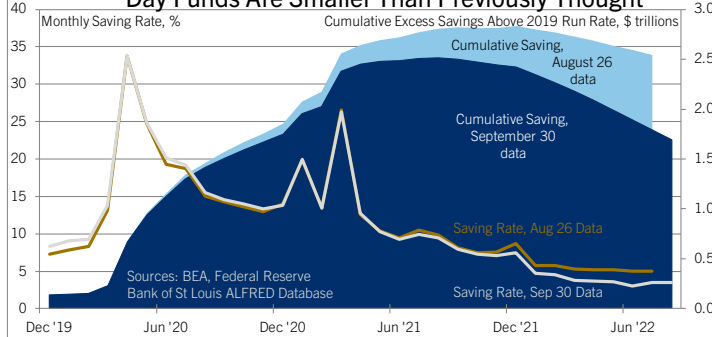
Residential Construction Slowed Since the Spring as Interest Rates Surged



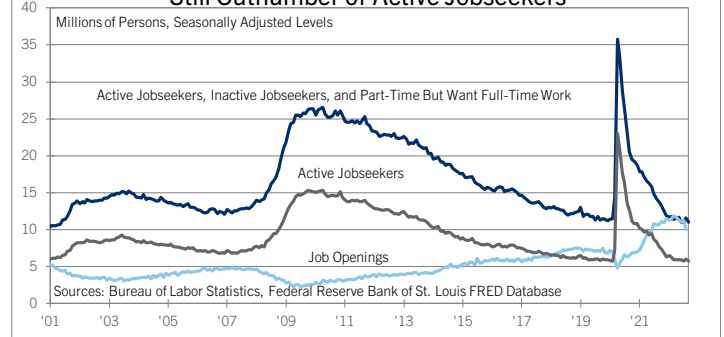
House Sales Falling to Early 2010s Levels as Mortgage Rates Jump Even Higher



Revisions to Savings Data Mean Household's Rainy Day Funds Are Smaller Than Previously Thought



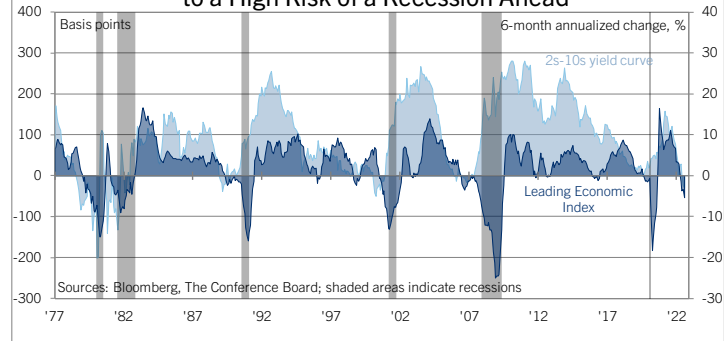
Job Openings Down 15% From March Peak, But Still Outnumber of Active Jobseekers



Dollar the Strongest Since Early 2000s, Hurting Exports and Stressing Emerging Market Economies



Yield Curve and Leading Economic Index Still Point to a High Risk of a Recession Ahead



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	1Q'22a	2Q'22a	3Q'22p	4Q'22f	1Q'23f	2Q'23f	3Q'23f	2021a	2022p	2023f	2024f
Output											
Nominal GDP (Billions \$)	24740	25248	25669	25838	25822	26119	26456	23315	25374	26280	27340
Percent Change Annualized	6.6	8.5	6.8	2.7	-0.2	4.7	5.3	10.7	8.8	3.6	4.0
Real GDP (Chained 2012 Billions \$)	19924	19895	19971	19891	19696	19795	19943	19610	19920	19868	20266
Percent Change Annualized	-1.6	-0.6	1.5	-1.6	-3.9	2.0	3.0	5.9	1.6	-0.3	2.0
Pers. Consumption Expenditures	14028	14099	14163	14071	13866	13945	14012	13754	14090	13982	14236
Percent Change Annualized	1.3	2.0	1.8	-2.6	-5.7	2.3	1.9	8.3	2.4	-0.8	1.8
Nonresidential Fixed Investment	2915	2916	2921	2895	2832	2844	2878	2835	2912	2869	3035
Percent Change Annualized	7.9	0.1	0.8	-3.6	-8.4	1.6	5.0	6.4	2.7	-1.5	5.8
Residential Investment	705	671	639	591	539	528	537	719	651	537	574
Percent Change Annualized	-3.1	-17.8	-17.7	-27.0	-30.7	-8.1	7.3	10.7	-9.4	-17.5	6.9
Change in Private Inventories	215	110	40	-30	-40	-10	-10	-19	84	-15	16
Net Exports	-1489	-1431	-1333	-1184	-1059	-1079	-1052	-1233	-1359	-1077	-1213
Government Expenditures	3393	3379	3391	3402	3413	3422	3431	3426	3392	3426	3467
Percent Change Annualized	-2.3	-1.6	1.4	1.3	1.2	1.1	1.0	0.6	-1.0	1.0	1.2
Industrial Prod. Index (2007=100)	102.9	104.2	104.6	104.4	103.0	103.3	104.0	100.0	104.0	103.8	105.9
Percent Change Annualized	4.7	5.3	1.7	-1.0	-5.1	1.1	2.8	4.9	4.0	-0.2	2.1
Capacity Utilization (Percent)	79.4	80.1	80.1	79.7	78.5	78.1	78.3	77.4	79.8	78.3	78.5
Prices											
CPI (1982-84=100)	284.6	291.8	295.6	300.2	303.6	305.6	307.5	271.0	293.1	306.4	312.2
Percent Change Annualized	9.2	10.5	5.3	6.4	4.6	2.6	2.5	4.7	8.2	4.6	1.9
PCE Price Index (2012=100)	120.3	122.5	123.6	125.1	126.4	127.2	127.8	115.6	122.9	127.5	129.7
Percent Change Annualized	7.5	7.3	3.7	5.0	4.4	2.3	2.2	4.0	6.3	3.7	1.8
GDP Price Index (2012=100)	124.2	126.9	128.6	129.9	131.1	131.9	132.7	118.9	127.4	132.3	134.9
Percent Change Annualized	8.3	9.0	5.3	4.2	3.6	2.7	2.2	4.5	7.1	3.8	2.0
PPI, Final Demand (Nov. 2009=100)	135.2	139.2	139.3	140.2	141.0	141.7	142.2	126.7	138.5	142.1	145.2
Percent Change Annualized	13.3	12.1	0.4	2.5	2.2	2.0	1.6	3.9	8.1	3.3	2.1
Crude Oil, WTI (\$/barrel)	\$94	\$108	\$91	\$90	\$90	\$88	\$87	\$68	\$96	\$88	\$84
Labor Markets											
Payroll Jobs (Average Monthly Diff., Ths.)	573	409	377	50	-333	50	175	514	352	18	146
Unemployment Rate (Percent)	3.8	3.6	3.6	3.8	4.2	4.4	4.5	5.4	3.7	4.4	4.1
Average Weekly Hours	34.6	34.6	34.5	34.4	34.3	34.3	34.4	34.8	34.5	34.4	34.5
Population (Millions)	333.6	334.1	334.7	335.3	335.9	336.4	337.0	332.1	334.4	336.7	339.0
Percent Change Annualized	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Personal Income											
Average Hourly Earnings (\$)	31.64	31.98	32.34	32.65	32.89	33.08	33.29	30.60	32.15	33.23	34.35
Percent Change Annualized	5.2	4.5	4.5	4.0	3.0	2.3	2.6	4.2	5.1	3.3	3.4
Real Disp. Income (2012 Billions \$)	15109	15052	15108	15031	14850	14793	14865	16130	15075	14871	15196
Percent Change Annualized	-10.6	-1.5	1.5	-2.0	-4.7	-1.5	2.0	1.9	-6.5	-1.4	2.2
Personal Saving Rate (Percent)	4.3	3.4	3.4	4.3	5.3	5.8	6.0	11.8	3.9	5.8	6.6
Housing											
Housing Starts (Ths., Ann. Rate)	1720	1647	1493	1350	1262	1250	1261	1605	1552	1261	1293
Exst. SF Home Sales (Ths., Ann Rate)	5380	4780	4300	3862	3550	3739	3832	5418	4580	3748	4144
New SF Home Sales (Ths., Ann Rate)	776	612	572	503	451	455	467	769	616	463	510
Case/Shiller One-Family HPI (1/2000=100)	290.6	303.8	305.1	301.1	293.3	289.8	290.8	260.1	300.1	291.5	295.9
Year/Year Percent Change	20.0	19.4	14.3	8.8	0.9	-4.6	-4.7	17.1	15.4	-2.9	1.5
Consumer											
Consumer Confidence* (Conference Board)	108.1	103.4	102.3	98.9	83.8	81.3	83.5	112.7	103.2	83.9	100.9
Car and Light Truck Sales (Millions)	14.3	13.6	13.5	13.7	13.7	14.2	14.6	15.1	13.8	14.4	17.6
Retail & Food Service Sales (Monthly Avg, Bns)	661.3	678.6	683.3	683.6	667.4	674.4	677.8	619.6	676.7	675.2	686.7
Percent Change Annualized	14.0	10.9	2.8	0.2	-9.1	4.2	2.0	19.7	9.2	-0.2	1.7
Interest Rates (Percent)											
Federal Funds Rate (Effective)	0.12	0.76	2.26	3.58	4.58	4.63	4.38	0.08	1.68	4.42	3.17
Prime Rate	3.29	3.93	5.40	6.70	7.70	7.75	7.50	3.25	4.83	7.54	6.29
1-Month LIBOR	0.22	1.01	2.45	3.75	4.74	4.74	4.46	0.10	1.86	4.52	3.22
3-Month LIBOR	0.51	1.53	2.94	4.27	5.04	4.88	4.53	0.16	2.31	4.67	3.25
1-Yr. Treasury Rate	0.96	2.20	3.36	4.32	4.37	4.16	3.82	0.10	2.71	3.94	2.68
5-Yr. Treasury Rate	1.82	2.95	3.20	3.82	3.36	3.23	3.39	0.86	2.95	3.31	2.73
10-Yr. Treasury Rate	1.94	2.93	3.08	3.52	3.09	3.09	3.30	1.44	2.87	3.17	2.78
30-Yr. Fixed Rate Mortgage	3.79	5.24	5.55	6.94	7.33	6.86	6.50	2.96	5.38	6.72	5.31

a = actual p = preliminary f = forecast

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