OXFORD ECONOMICS

15 July 2022

# Weekly Economic Briefing | US

## Inflation has everyone's full attention

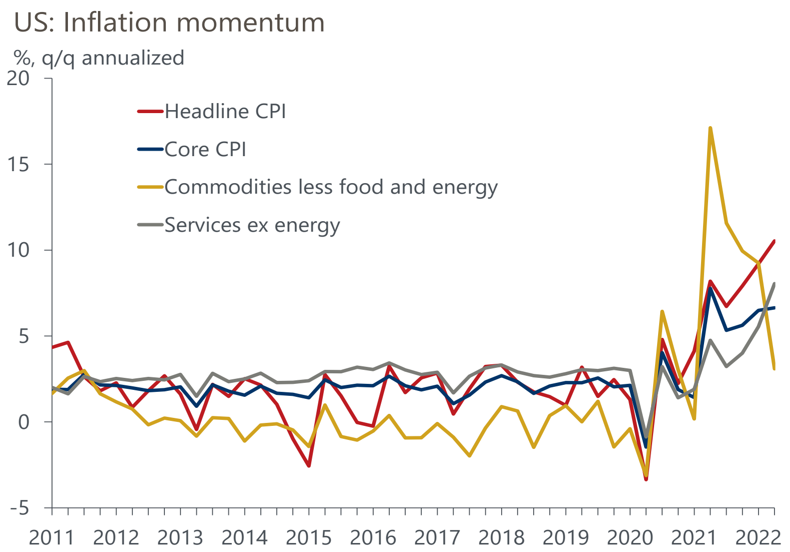
- **Fiery price increases in June catapulted headline CPI inflation above 9%, the fastest annual gain since November 1981. We don't see inflation pressures easing substantially in the near term, meaning household and corporate budgets will continue to be squeezed. Navigating through inflation's squalls to a soft landing is becoming harder but upbeat spending backed by a strong labor market and as consumers dip into their savings should keep the economy out of recession.**
- **Given we believe CPI inflation will only cool to around 7% y/y by year-end and the labor market remains extremely tight, the Fed's "unconditional" commitment to lower inflation will lead them to continue to aggressively front-load rate increases. Another 75bps rate hike is most likely in July. Recession isn't inevitable but risks are running high, especially for 2023.**

The headline CPI reading for June topped expectations, rising 1.3%, as prices rose strongly across the board. Overall, inflation's momentum was more concerning in Q2 (**Chart 1**). Further, headline CPI inflation accelerated to 9.1% y/y in June, the fastest pace since November 1981, while core CPI inflation dipped slightly but stayed highly elevated at 5.9% y/y. PPI inflation was also higher than expected in June. On the bright side, consumer inflation expectations eased slightly this month as gasoline prices fell.

Unsurprisingly, Fed officials didn't find the inflation data very comforting. Among the officials commenting this week, Cleveland Fed President Mester said "inflation is too high" and that she doesn't see convincing evidence that inflation has peaked. "Everything is in play" for Atlanta Fed President Bostic after he was asked whether a 100bps rate hike in July is on the table (though the dip in consumer inflation expectations might convince him only a 75bps hike is needed). And Richmond Fed President Barkin believes it is worth risking pushing the economy into recession if much tighter monetary policy will bring down inflation.

We see the Fed raising the fed funds rate by 75bps at each of the July and September policy meetings since inflation is poised to remain sticky and elevated. A 100bps rate hike at the next meeting isn't out of the question but the chances are low. The Fed's "unconditional" commitment to lower inflation will lead officials to continue to aggressively front-load rate increases. We expect the policy rate to peak in a range of 3.75%-4% in 2023.

**Chart 1: Inflation momentum is trending in a concerning direction**




*Source: Oxford Economics/Haver Analytics*

**Oren Klachkin - Lead US Economist - oklachkin@oxfordeconomics.com**

Improving supply chain conditions should temper inflation in the months ahead, all else equal. Supply chain constraints loosened in June, according to our tracker. Pressures eased most on the inflation front, though prices were still very high. Logistics faced less challenges as logjams declined and shipping prices retreated. Stress declined on the inventories front and there was a healthier balance between labor demand and supply. Activity was the only component of our tracker to record a higher level of stress.

Retail sales showed consumers continue to spend at a solid rate on goods in June even as they shifted more towards services consumption. Importantly, data through Q2 show that consumer outlays are slowing but not contracting. With inflation reaching new heights and prices at the pump soaring, consumers will likely redirect their spending priorities and allocate more of their budget toward services and necessities such as gas, food and shelter.

Small business sentiment remains depressed amid a historically challenging economic backdrop. Business attitudes will likely remain downbeat as inflation continues to sting, demand cools and supply-side constraints won't ease quickly.

On the labor market front, initial jobless claims crept higher to 244k in the week ended July 9, the highest level of claims since November. While we think the risk is for further increases in jobless claims as economic growth slows, we don't anticipate a sharp rise in claims any time soon.

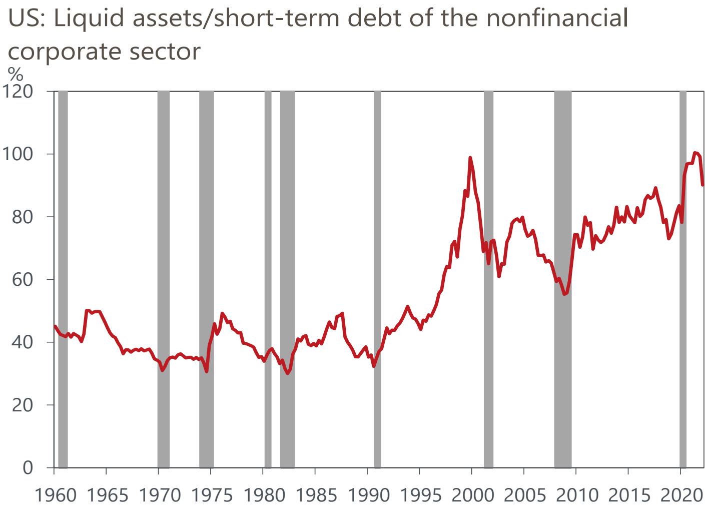
News from goods producing sectors wasn't too reassuring. Industrial production was softer than expected in June, declining 0.2%, and output for May was revised lower, signaling slower industrial sector growth. The Empire State Manufacturing index indicated factory activity is growing moderately in July, however firms expect activity to decline in the near term, a view rarely held by manufacturers since the NY Fed started conducting the survey.

The latest Beige Book report indicated that economic activity has advanced at a modest pace since mid-May, though several Fed districts reported "growing signs" of a slowdown in demand. But again, with inflation the priority, we believe the Fed will pursue expeditious, front-loaded policy tightening.

We believe US corporates can stand the heat of rising rates. Outstanding nonfinancial corporate sector debt stood at 50% of GDP in Q1 2022, not far below the all-time high reached in 2020. But balance sheets are healthier today due to greater profitability, long debt maturity profiles, and decisions to lock-in near-zero borrowing rates. What's more, the nonfinancial corporate sector has a historically high level of liquid assets to meet short-term debt obligations and the banking sector is well positioned to handle corporate debt stress (**Chart 2**). There are disparities at the industry-level, but none are too concerning right now to change our positive view on the corporate debt picture.

A greater risk, in our view, is that if interest rates stay relatively high amid a moderating economic expansion, companies will have less cash to meet their debt obligations as revenue growth slows.

### Chart 2: US corporates can meet their near-term obligations




*Source: Oxford Economics/Haver Analytics*

## The week ahead

The data calendar in the week ahead has a heavy emphasis on the housing market. We expect the **NAHB homebuilder sentiment** gauge to fall 2pts to 65 in July, as higher interest rates limit the pool of potential homebuyers. Meanwhile, we estimate that **housing starts** rose about 3% in June, reflecting permit issuance in previous months. We think new **building permits** declined around 3%. We think **existing home sales** fell about 3% in June, dragged down by a sharp erosion in homebuying affordability.

We expect that **initial jobless claims** edged up to 247k in the week ended July 16. Meanwhile, **Philly Fed manufacturing** activity likely firmed modestly this month.

**Table 1: Week ahead calendar**

| Date | Events | Period | Previous | Consensus | Estimate |
|---|---|---|---|---|---|
| 7/18/2022 | NAHB Housing Market Index | Jul | 67.0 | 67.0 | 65.0 |
| 7/19/2022 | Housing Starts | Jun | 1549k | 1595k | 1600k |
| 7/19/2022 | Building Permits | Jun | 1695k | 1680k | 1650k |
| 7/20/2022 | Existing Home Sales | Jun | 5.41m | 5.40m | 5.31m |
| 7/21/2022 | Philadelphia Fed Business Outlook | Jul | -3.3 | -0.5 | 1.6 |
| 7/21/2022 | Initial Jobless Claims | Jul | 244k | 240k | 247k |

*Source: Oxford Economics/Haver Analytics*

**Table 2: Latest US forecast overview**

| (Annual percentage changes unless specified) | | | | | | |
|---|---|---|---|---|---|---|
| | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
| GDP | 2.3 | -3.4 | 5.7 | 1.9 | 1.1 | 2.1 |
| Private consumption | 2.2 | -3.8 | 7.9 | 2.5 | 1.6 | 2.3 |
| Fixed investment | 3.1 | -1.5 | 6.1 | 1.8 | 0.7 | 2.5 |
| Government consumption | 2.0 | 2.0 | 1.0 | -0.7 | 0.7 | 0.6 |
| Exports of goods and services | -0.1 | -13.6 | 4.5 | 5.7 | 5.6 | 4.1 |
| Imports of goods and services | 1.1 | -8.9 | 14.0 | 10.0 | 2.1 | 2.1 |
| Industrial production | -0.7 | -7.0 | 5.0 | 5.3 | 1.4 | 1.5 |
| Consumer prices | 1.8 | 1.2 | 4.7 | 8.0 | 3.2 | 1.8 |
| Unemployment rate (%) | 3.7 | 8.1 | 5.4 | 3.6 | 3.8 | 3.8 |
| Current a/c balance (% of GDP) | -2.1 | -3.0 | -3.7 | -4.7 | -4.3 | -3.8 |
| Government balance (% of GDP) | -4.6 | -15.0 | -12.1 | -4.3 | -4.4 | -5.7 |
| Cen. bank policy rate (%, EOP) | 1.63 | 0.13 | 0.13 | 3.63 | 2.13 | 2.00 |
| 10yr govt. bond yield (%, EOP) | 1.92 | 0.93 | 1.52 | 3.50 | 3.01 | 2.78 |
| Exchange rate (Yen per US$, EOP) | 109.12 | 103.54 | 115.00 | 132.18 | 119.36 | 109.02 |
| Exchange rate (US$ per euro, EOP) | 1.12 | 1.23 | 1.13 | 1.05 | 1.08 | 1.11 |

*Source: Oxford Economics*

**Table 3: Latest quarterly forecasts for the US**

| | 2021 | 2021 | 2022 | 2022 | 2022 | 2022 | 2023 | 2023 |
|---|---|---|---|---|---|---|---|---|
| | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 |
| GDP (% chg, saar) | 2.3 | 6.9 | -1.4 | 0.5 | 1.5 | 1.4 | 1.1 | 0.3 |
| CPI inflation (% year) | 5.3 | 6.7 | 8.0 | 8.4 | 8.5 | 7.3 | 5.5 | 3.5 |
| Core CPI inflation (% year) | 4.1 | 5.0 | 6.3 | 5.9 | 6.0 | 5.5 | 4.6 | 3.4 |
| PCE inflation (% year) | 4.3 | 5.5 | 6.3 | 6.4 | 6.4 | 5.5 | 4.2 | 2.9 |
| Core PCE inflation (% year) | 3.6 | 4.6 | 5.2 | 4.7 | 4.7 | 4.2 | 3.5 | 2.9 |
| 10-year Treasury yield (%, EOP) | 1.5 | 1.5 | 2.3 | 3.0 | 3.3 | 3.5 | 3.4 | 3.3 |
| Federal funds rate (%, EOP) | 0.1 | 0.1 | 0.4 | 1.6 | 3.1 | 3.6 | 3.9 | 3.9 |

*Source: Oxford Economics*

## Latest Country Economic Forecast:

13 July 2022

## Recent publications

### Data Insights

- Declines in manufacturing, utilities weigh on industrial production
- Retail sales show consumers have staying power
- Consumer sentiment remains weak, but inflation outlook eases
- Budget deficit in 2022 is a shadow of its 2021 self
- CPI inflation breaks through 9%

### Research Briefings

- Home affordability worsens as rates rise
- Why corporates can stand the heat from rising rates
- Supply chain easing may bode well for inflation
- Jobs machine set to cooling mode, with risk of a jam
- FOMC Minutes: Inflation concerns lead to restrictive Fed policy
- Employment preview - Jobs slowdown underway

## Contacts

### Oxford Economics' North American team


- Kathy Bostjancic - Chief US Economist - kathybostjancic@oxfordeconomics.com
- Nancy Vanden Houten - Lead US Economist - nvhouten@oxfordeconomics.com
- Oren Klachkin- Lead US Economist - oklachkin@oxfordeconomics.com
- Lydia Boussour - Lead US Economist - lboussour@oxfordeconomics.com
- John Canavan - Lead US Analyst - jcanavan@oxfordeconomics.com
- Mahir Rasheed - US Economist - mrasheed@oxfordeconomics.com
- Tony Stillo - Director of Canada Economics - tstillo@oxfordeconomics.com
- Michael Davenport - Canada Economist - mdavenport@oxfordeconomics.com
- Bob Schwartz - Director of Consulting Services - bschwartz@oxfordeconomics.com
- Matthew Martin - Economic Research Analyst Intern - mmartin@oxfordeconomics.com