

Feeling the Heat

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Where Do We Go From Here?

Self-Sustaining Economic Expansion (50% probability)

- Economy returns to full employment by summer 2022, and inflation to near the Fed's target by year-end 2023.
- Assumes pandemic continues to fade, the disruption to Russian oil (35% export reduction) and other commodity exports is modest, and the Federal Reserve successfully calibrates monetary policy.

Recession (40% probability)

- Economy suffers a typical recession in the next 12-18 mo, characterized by higher unemployment (7%) and quickly moderating inflation.
- Potential catalysts are an intensifying pandemic, greater disruptions to Russian oil (60% export reduction), and/or tightening monetary policy and financial conditions.

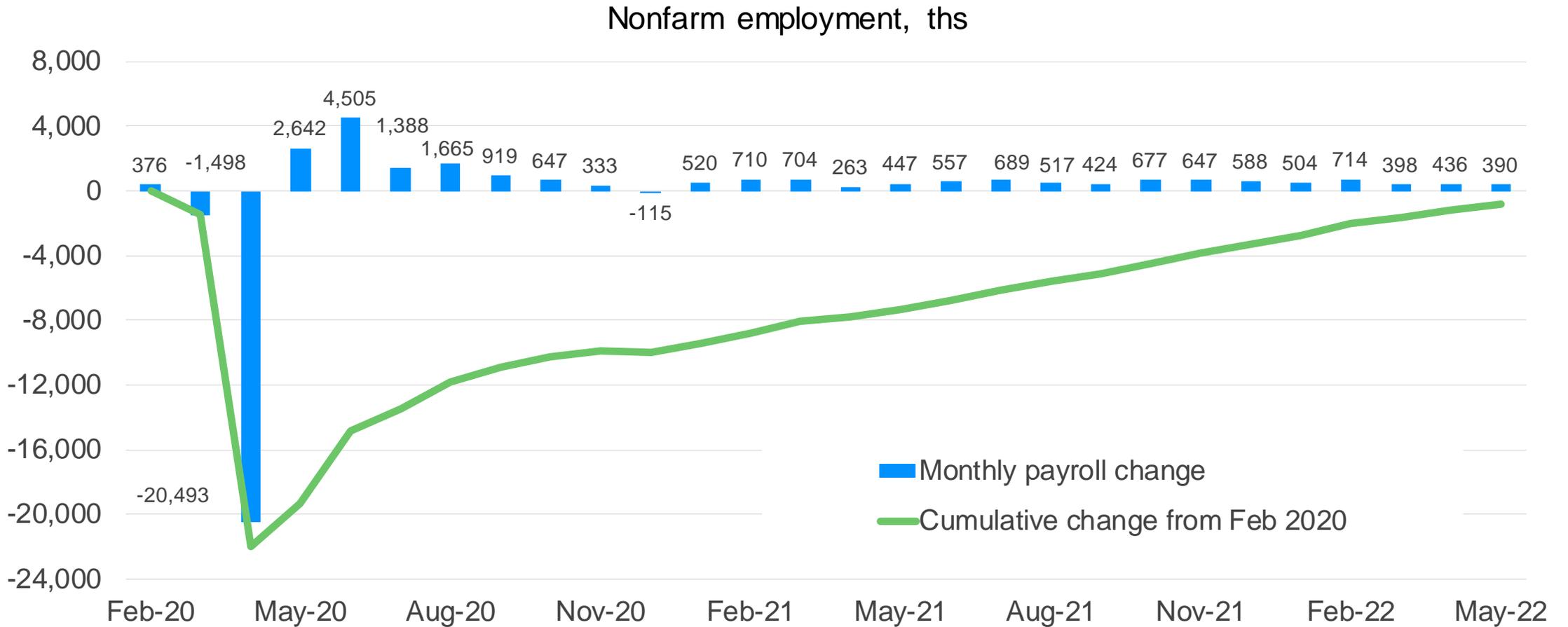
Stagflation (5% probability)

- Economy suffers persistently high unemployment (>5%) and inflation (>4%) into mid-decade.
- The Federal Reserve is slow to respond to untethered inflation expectations, igniting a wage-price spiral.

Supply-Side Surprise (5% probability)

- Productivity and labor force growth are surprisingly strong, quelling inflationary pressures.
- Consistent with currently strong business investment and formations, remote work, and stronger foreign immigration.

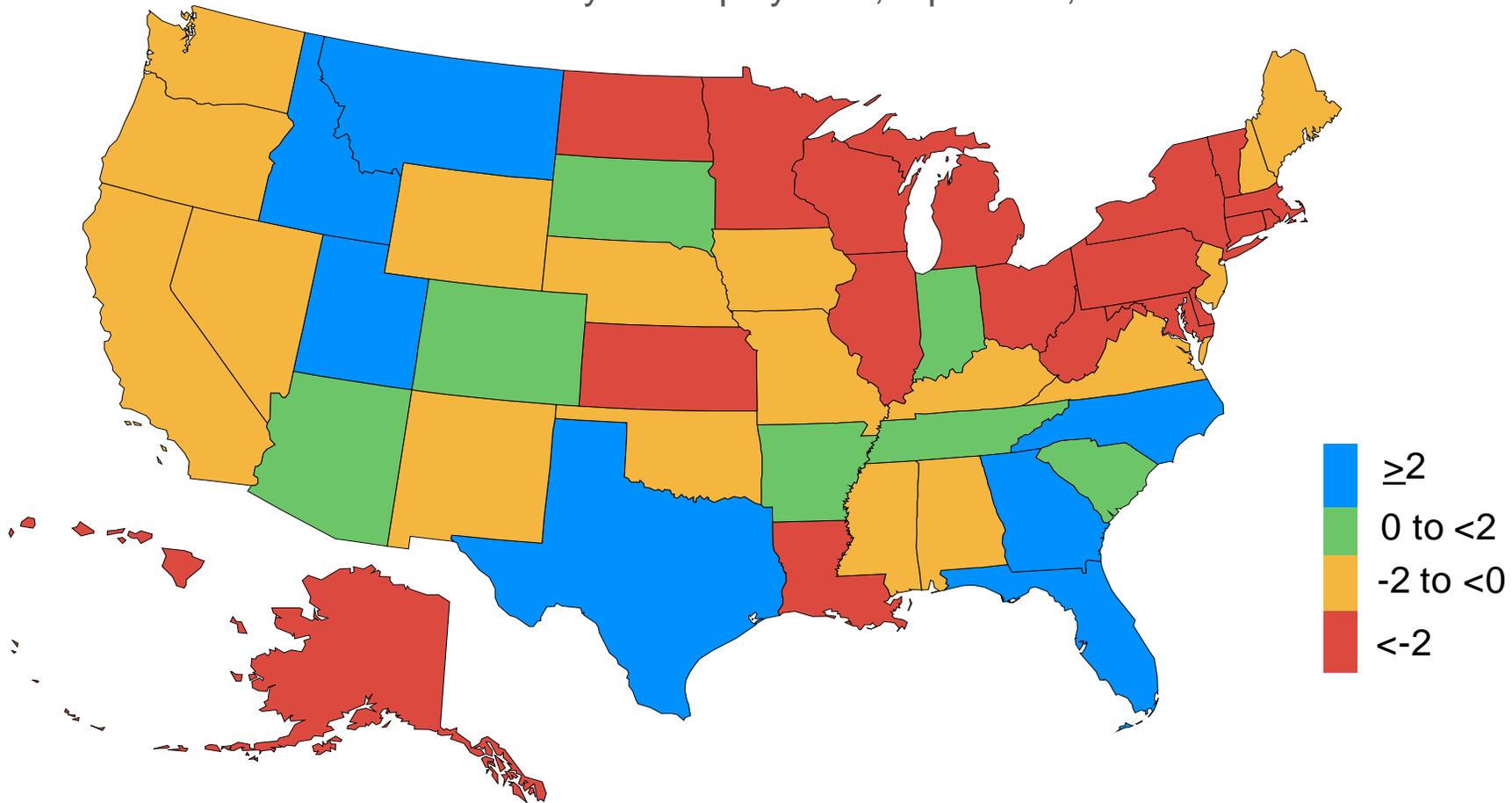
Recovery in Payroll Employment Has Been Steady



Sources: BLS, Moody's Analytics

Labor Market Recoveries Vary Widely by Region...

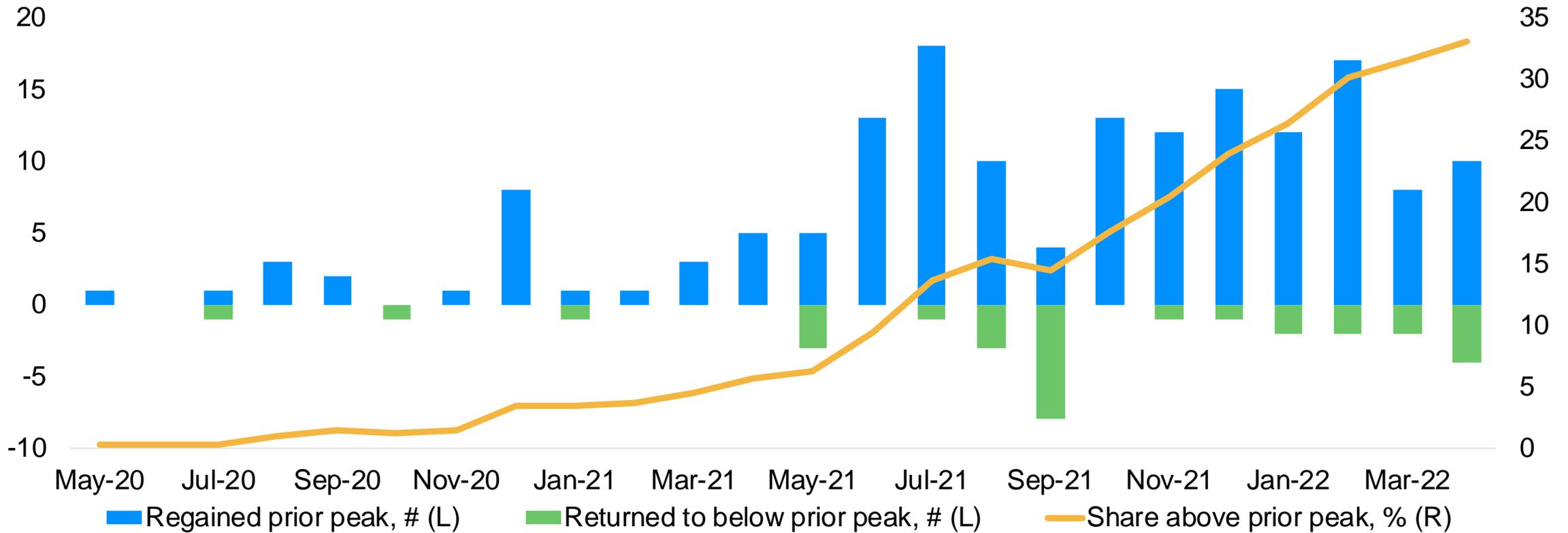
Payroll employment, Apr 2022, % diff from Feb 2020



Sources: BLS, Moody's Analytics

...With Fewer Metro Areas Returning to Prior Peaks Each Month

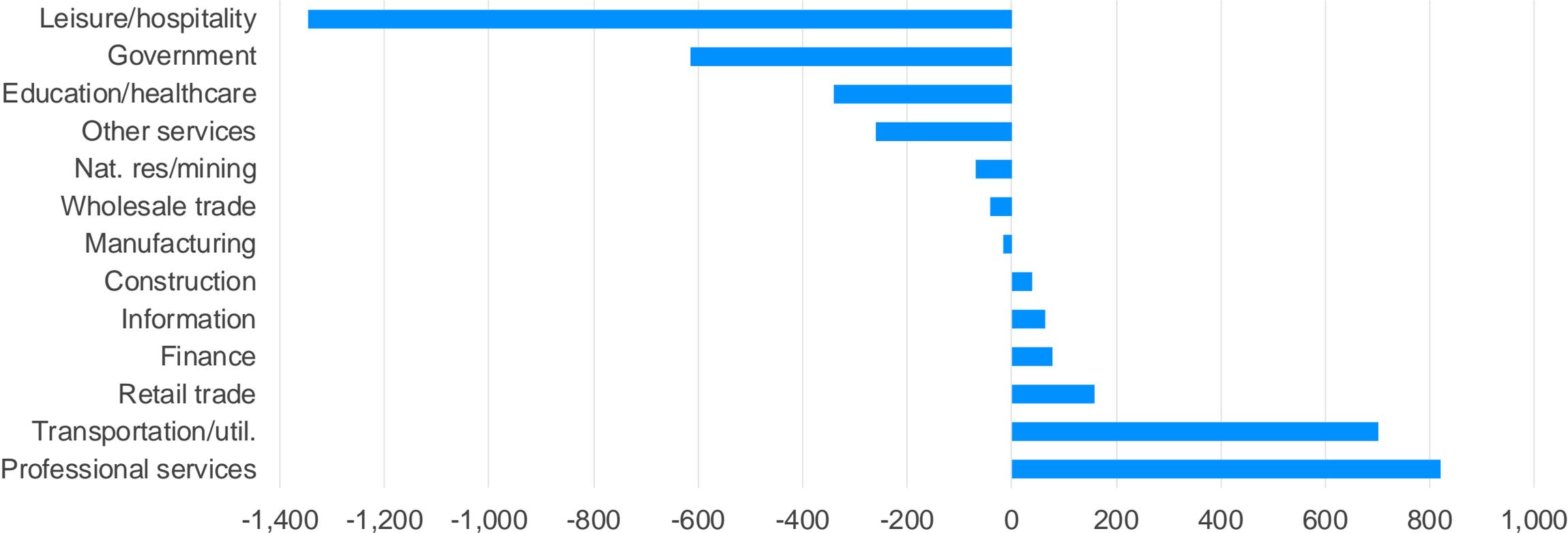
Payroll employment relative to early 2020



Sources: BLS, Moody's Analytics

Most of Remaining Deficit Resides in Leisure/Hospitality and Government

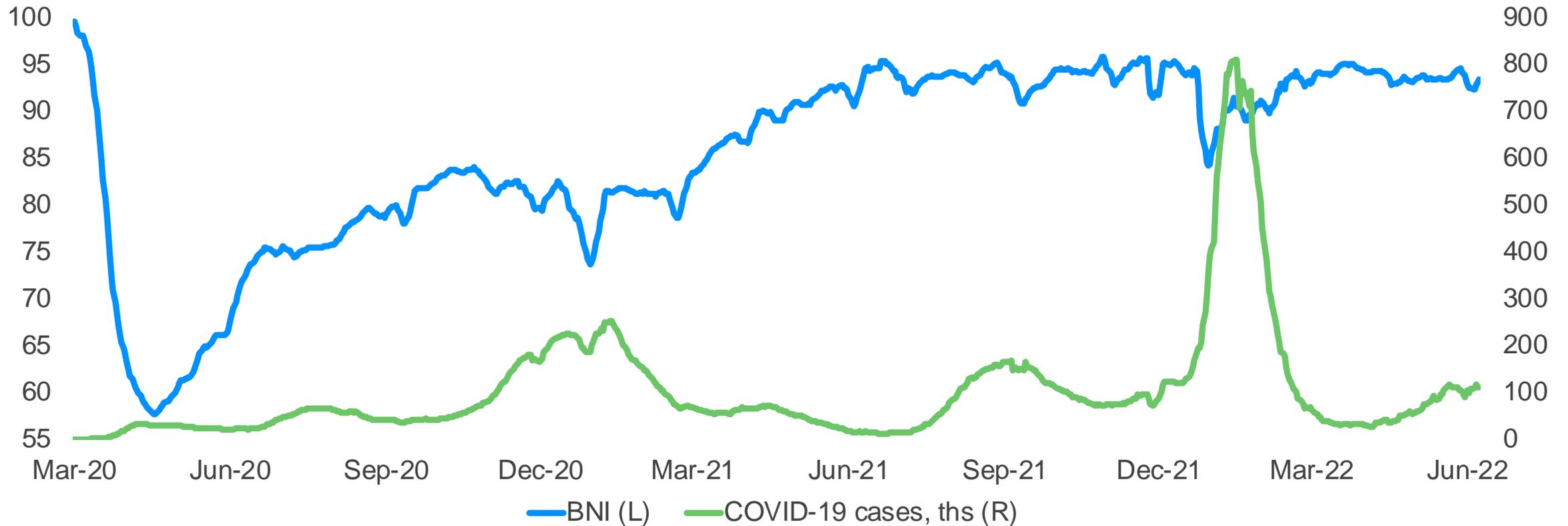
Payroll employment, ths, May 2022 minus Feb 2020



Sources: BLS, Moody's Analytics

Economy Grows Less Vulnerable to the Pandemic

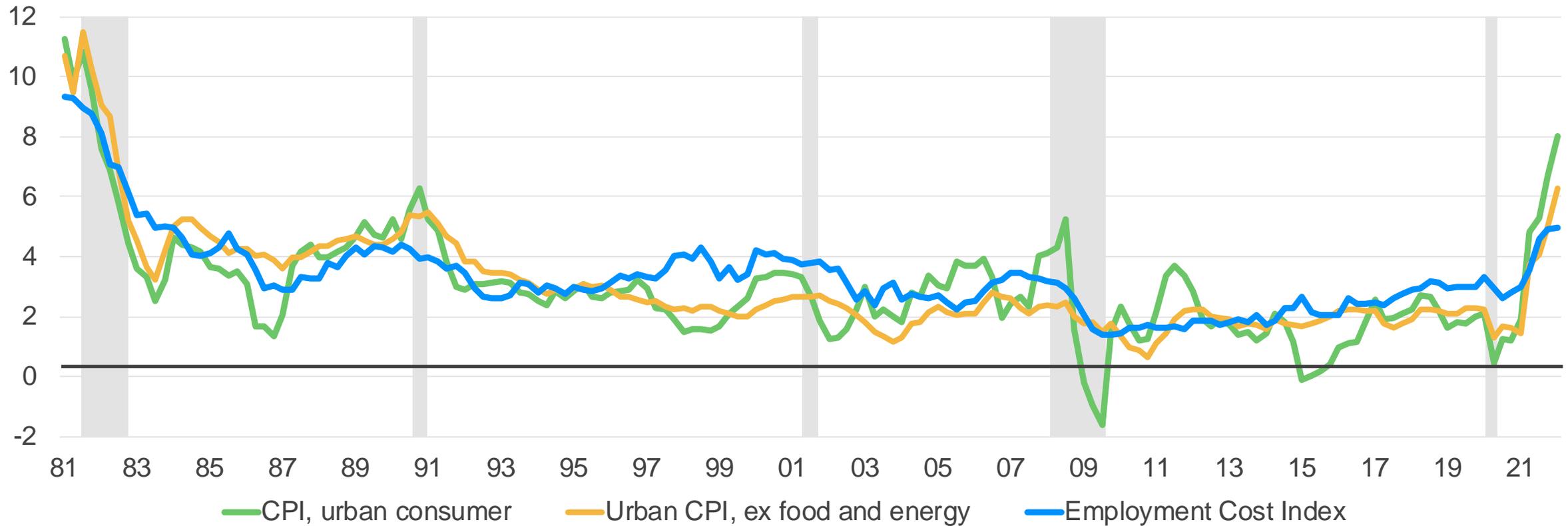
Moody's Analytics & CNN Business Back-to-Normal Index vs. U.S COVID-19 cases, ths, 7-day MA



Sources: Our World in Data, CNN Business, Moody's Analytics

Wage Gains Are Still Not Keeping Up With Inflation...

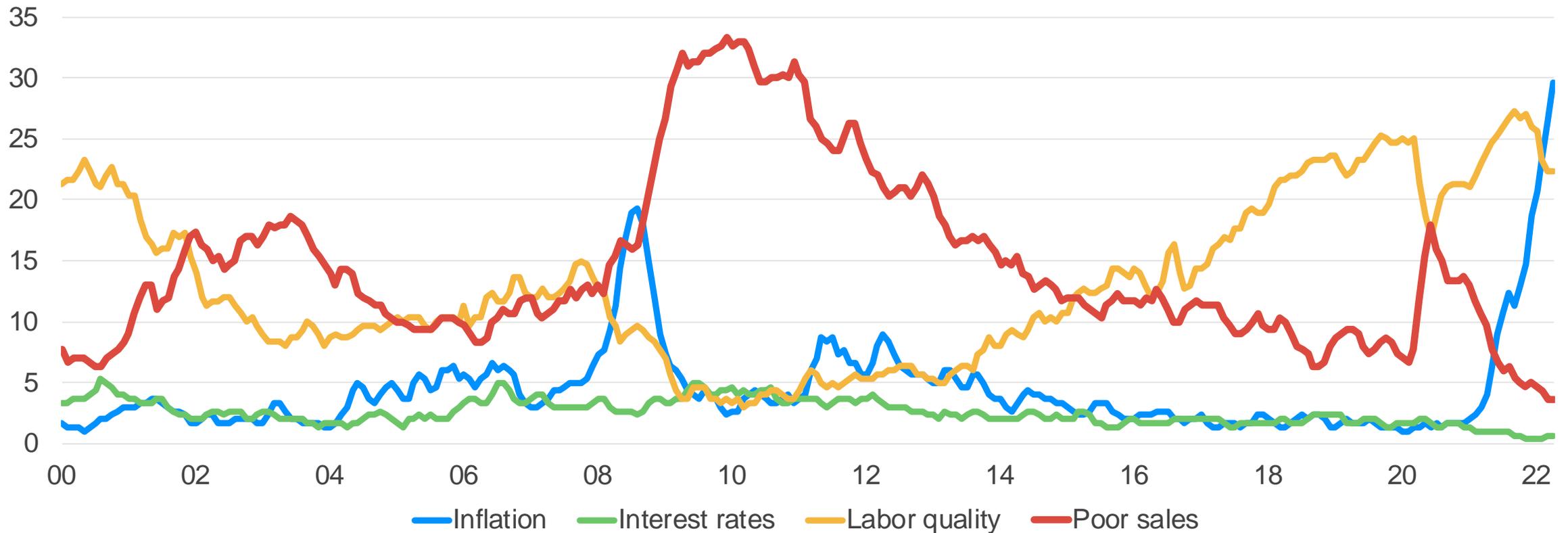
Quarterly avg, % change yr ago



Sources: BEA, BLS, Moody's Analytics

...And Employers See Rising Costs as a Major Problem

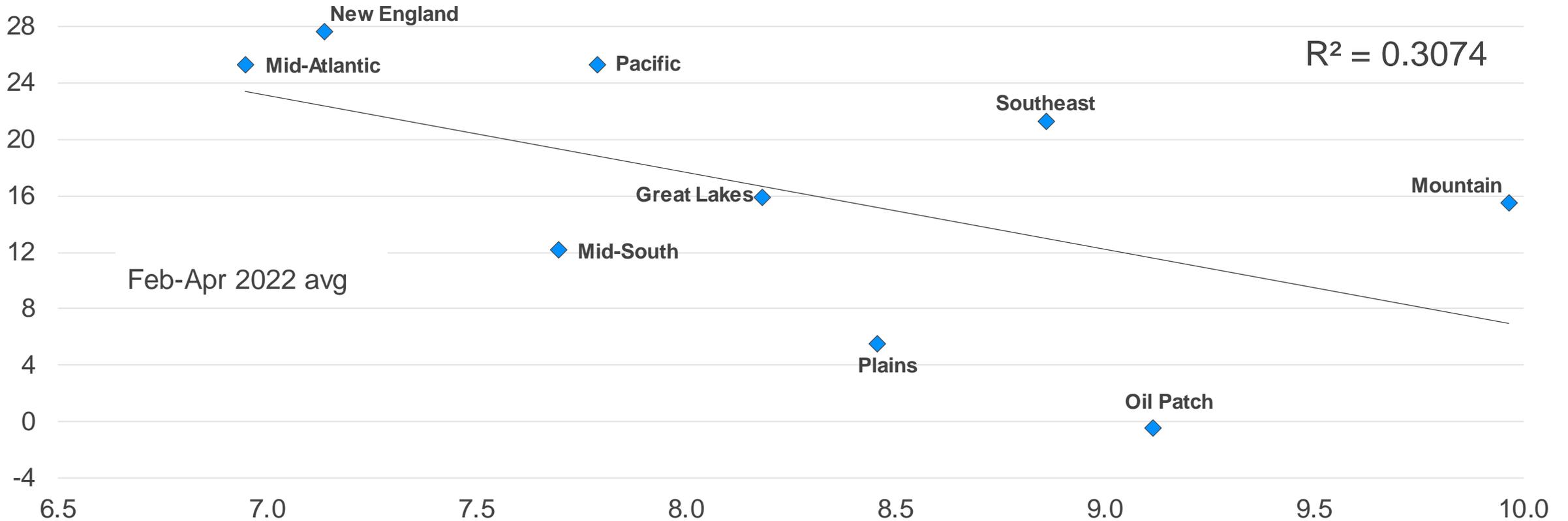
Net % of businesses reporting their primary concern is..., 3-mo MA



Sources: National Federation of Independent Businesses, Moody's Analytics

High Inflation Is Linked to Diminished Confidence

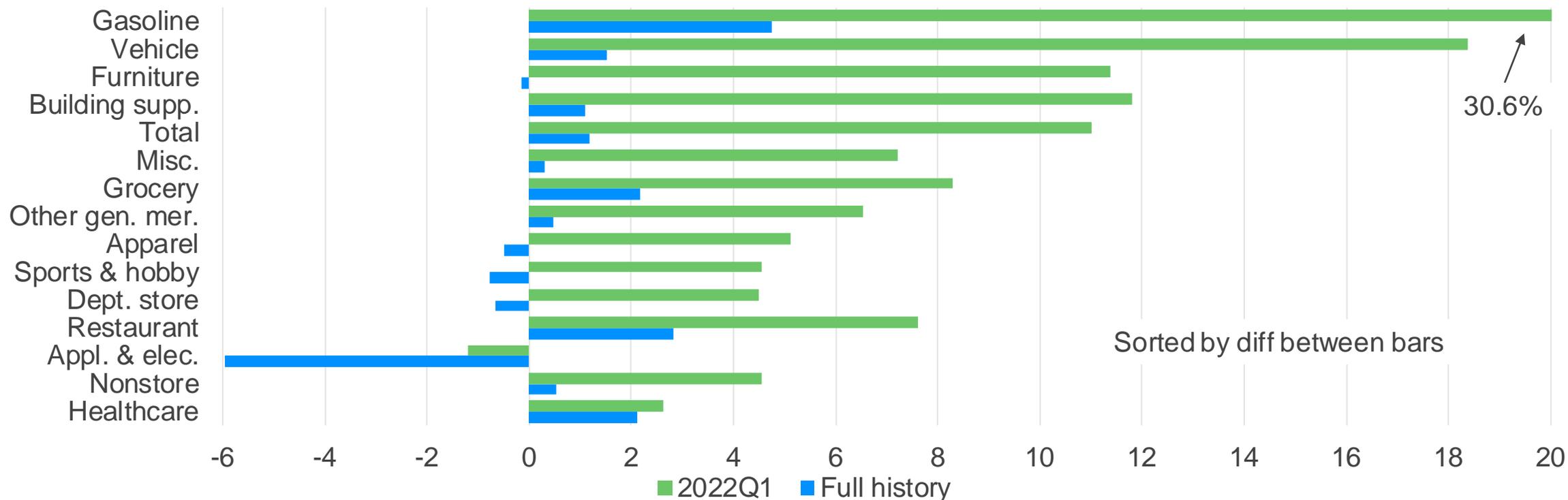
Consumer Price Index, % change yr ago vs. consumer confidence, % diff vs. 2010s avg (Y)



Sources: BLS, The Conference Board, Moody's Analytics

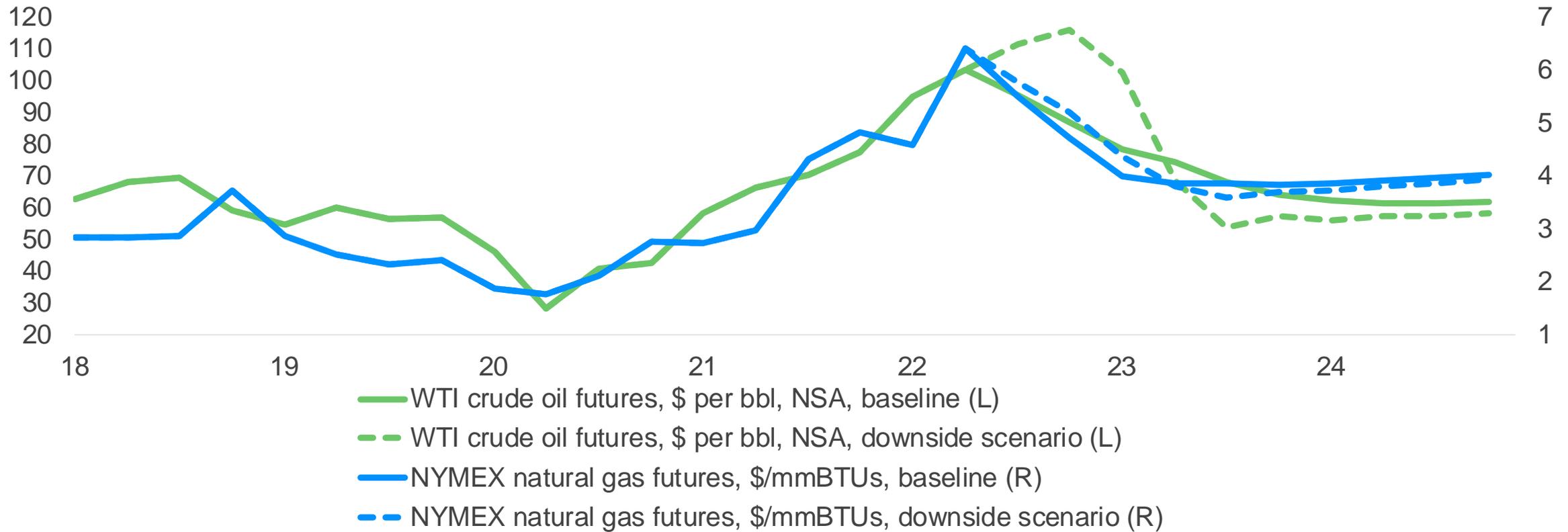
Retail Pricing Power Is Almost Universally Strong

Retail deflator, % change yr ago, avg



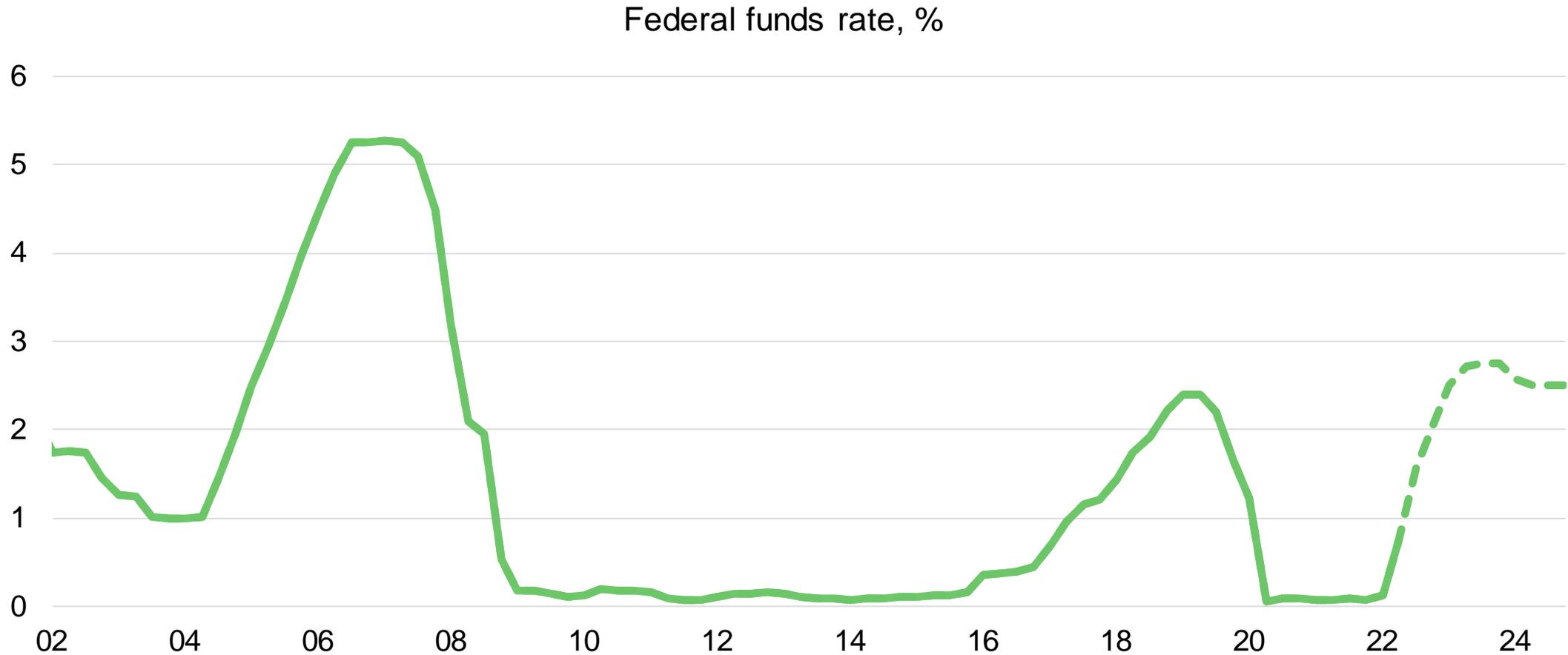
Sources: BEA, Moody's Analytics

Energy Prices Have (Probably) Peaked



Sources: EIA, Moody's Analytics

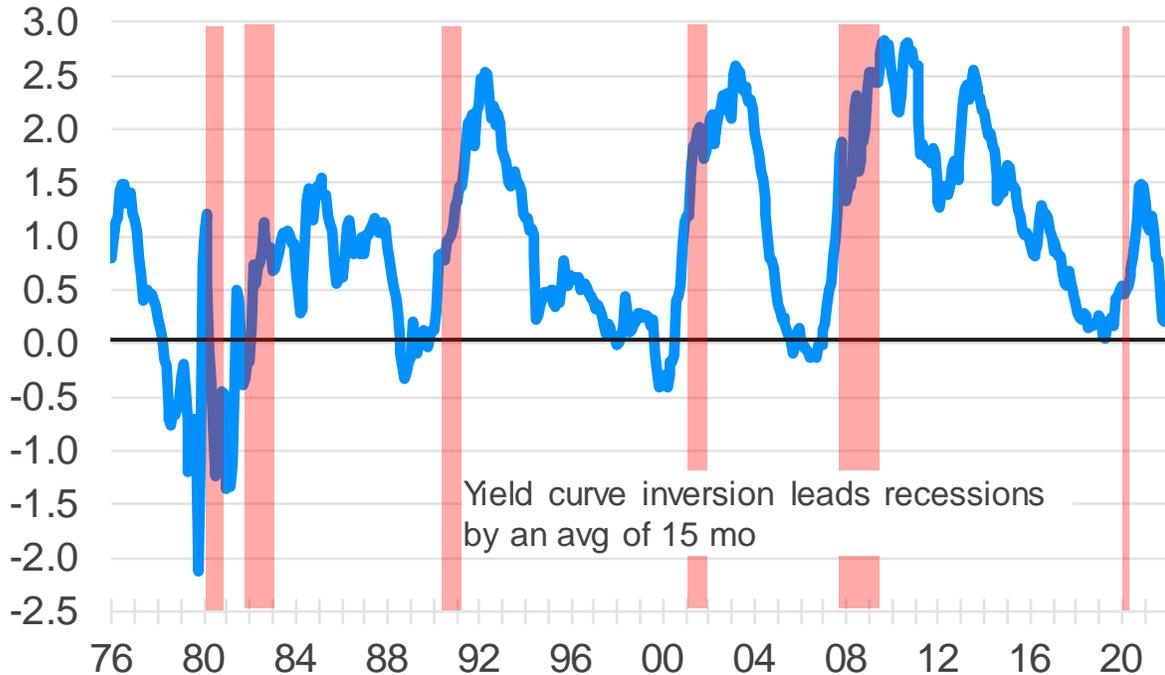
Fed Is Prepared to Tighten Aggressively...



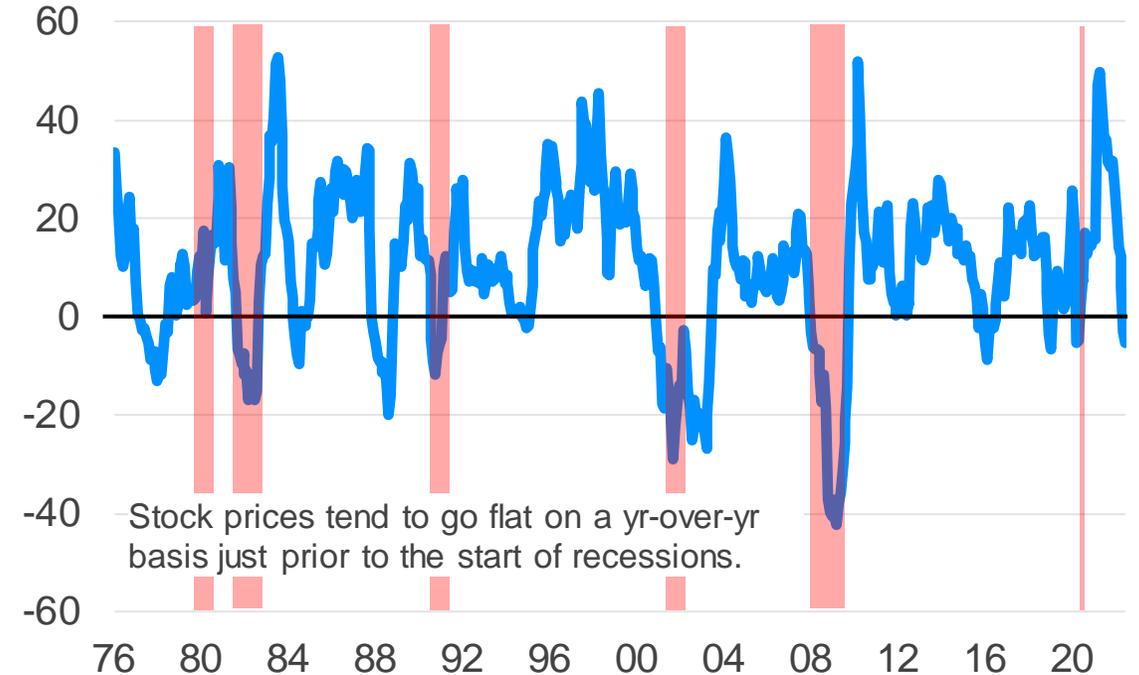
Sources: Federal Reserve, Moody's Analytics

...Making Markets Increasingly Nervous

Difference between 10-yr Treasury and 2-yr Treasury yield, ppt



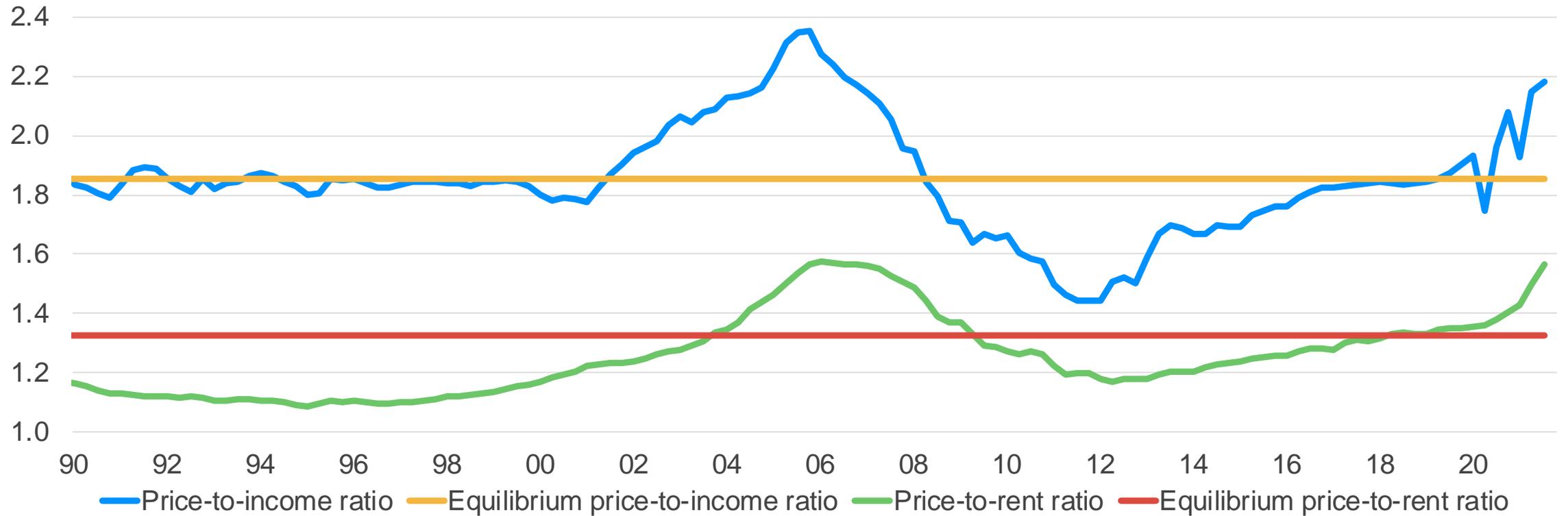
S&P 500 index, % change yr ago



Sources: Federal Reserve, S&P, Moody's Analytics

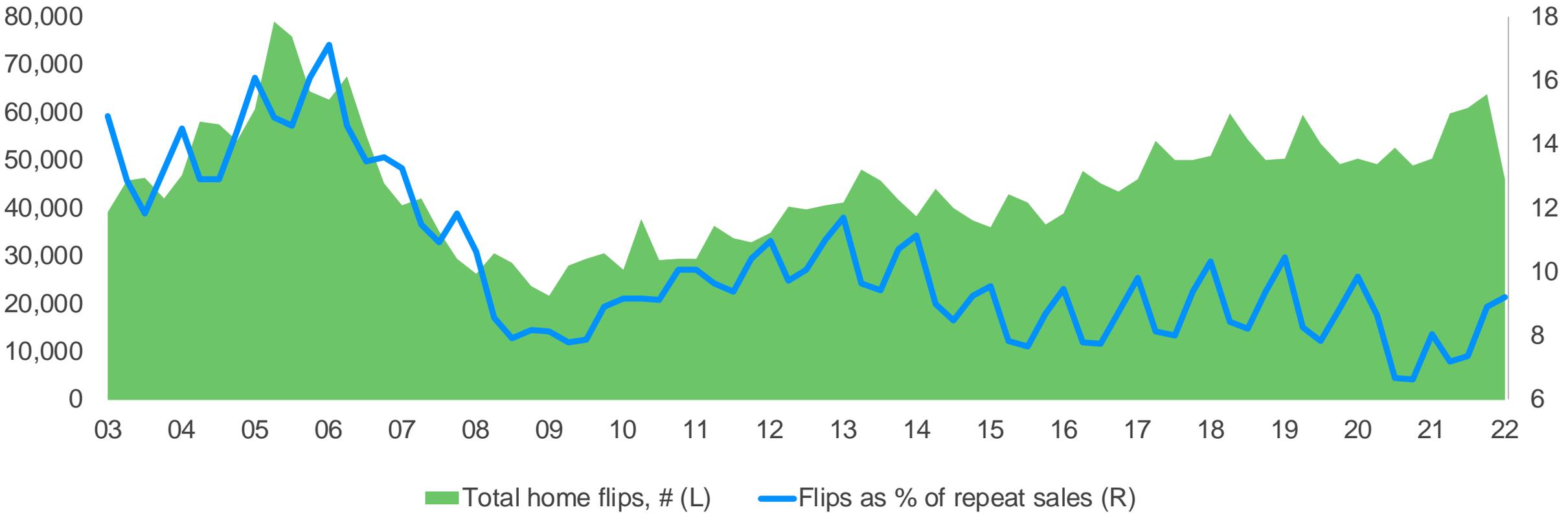
House Price Ratios Suggest Overvaluation...

House price valuation ratios, %



Sources: NAR, BEA, Census Bureau, BLS, FHFA, Moody's Analytics

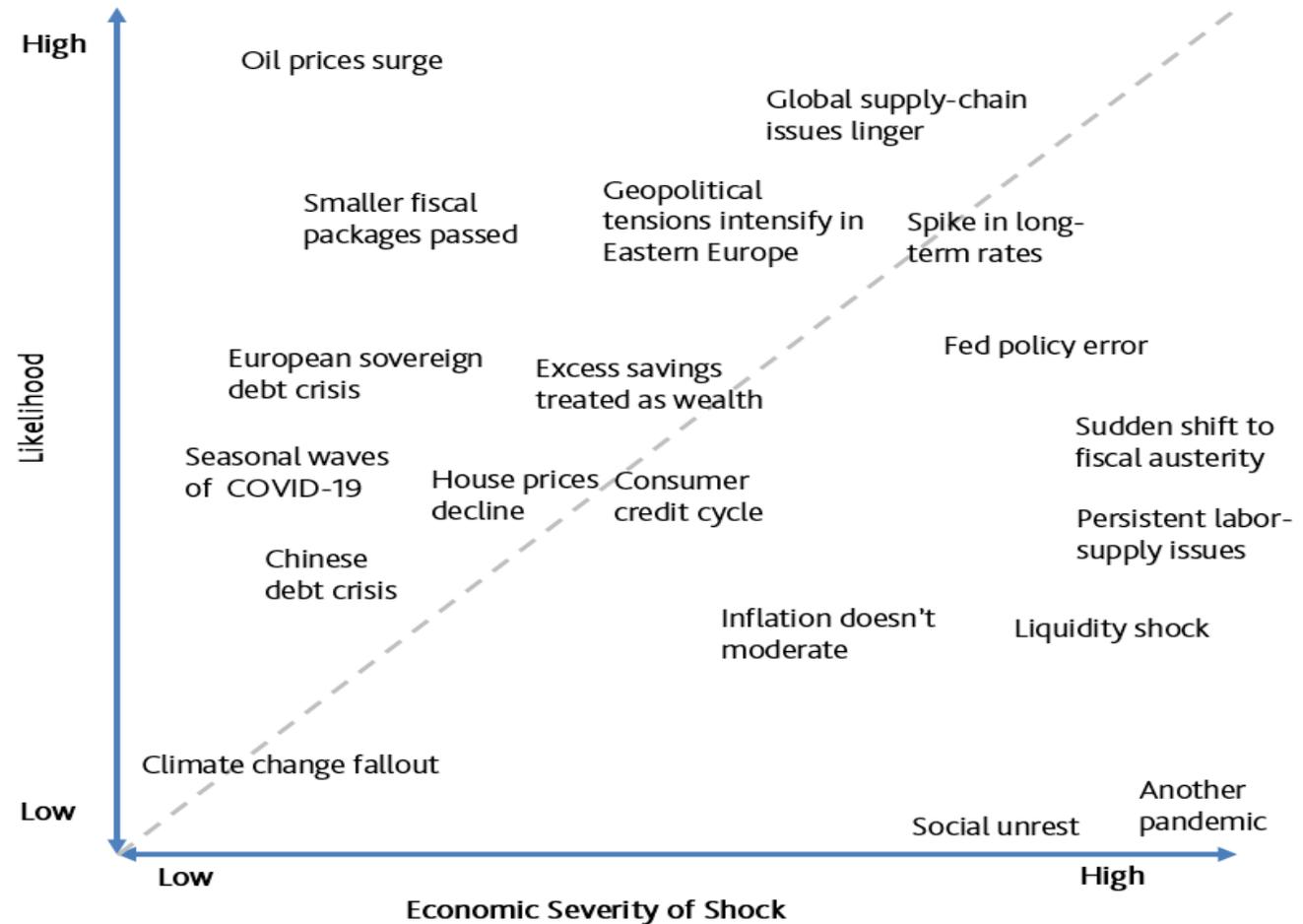
...But a Lack of Flips Means No Bubble



Source: Moody's Analytics

What Could Go Wrong?

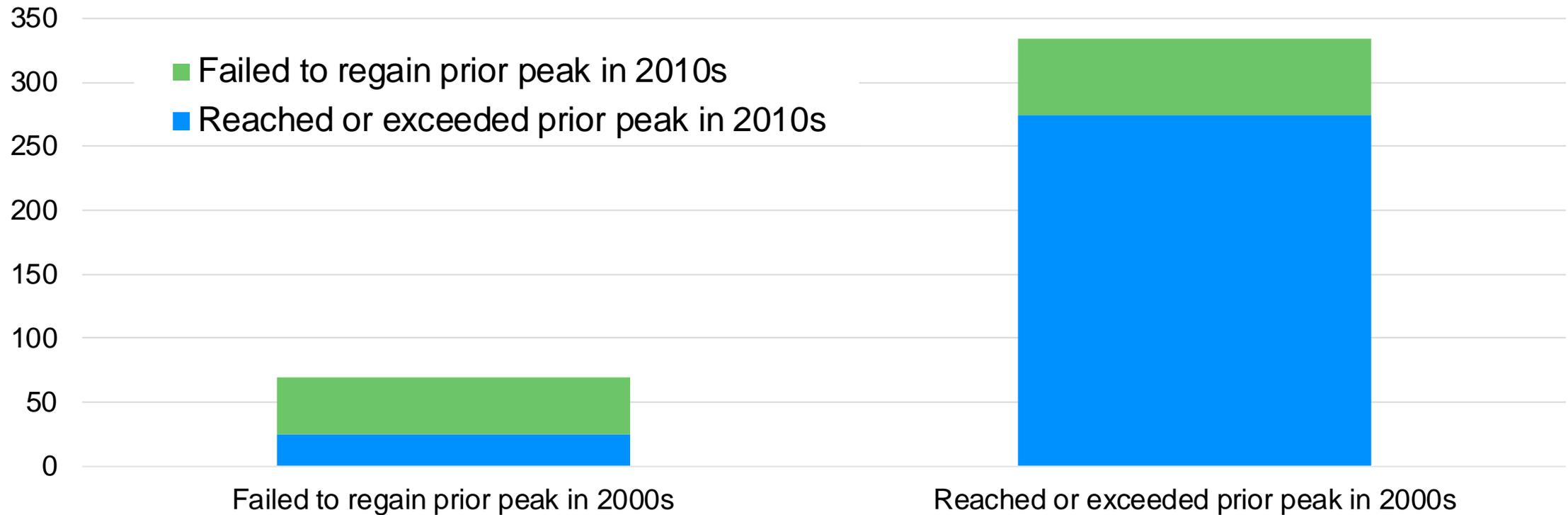
1. Inflationary shock
2. Fed policy error
3. Sharp asset price correction
 - Equities/housing
4. Another shock
 - Geopolitical
 - COVID-19
 - Cyberattack/other



Source: Moody's Analytics

Inability to Regain Prior Heights Can Have Longer-Term Consequences

Payroll employment, count of metro areas



Sources: BLS, Moody's Analytics

Q&A

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