RESEARCH SEMINAR IN QUANTITATIVE ECONOMICS
UNIVERSITY OF MICHIGAN

Gabriel M. Ehrlich, Director

George A. Fulton & Saul H. Hymans
Directors Emeriti

University of Michigan, Ann Arbor
Department of Economics
611 Tappan Avenue
Ann Arbor, MI 48109-1120

lsa.umich.edu/econ/rsqe
734-764-2567

For Release: 05/20/2022

The U.S. Economic Outlook for 2022–2024
Executive Summary: May 2022

Pandemic Bids Farewell, No Normal in Sight

The fluky first quarter real GDP contraction, at a 1.4 percent annualized pace, was accounted for by a sharp deterioration in net exports. Normally, however, an outsized jump in imports would fuel consumption growth or contribute to a faster pace of inventory investment. Considerable production and consumption disruptions due to the Omicron wave of the pandemic likely held back both consumption and inventory investment in 2022Q1. The recent stock market rout notwithstanding, the near-term growth momentum appears strong, and we project solid economic growth to resume in 2022Q2.

The outlook beyond the very near term is unusually uncertain. The Russian invasion of Ukraine in late February dashed hopes that the year 2022 would see the global economic environment trend toward normalcy. The war in Ukraine and sanctions on Russia have already contributed to sharp increases in energy prices and will likely fuel more consumer and producer price inflation, and intensify supply chain strains. The interplay between the war, inflation, the receding pandemic, and the rapidly changing policy environment makes for an extremely challenging environment to forecast.

Is That a Light or a Train?

In April, year-over-year headline CPI inflation dipped to 8.2 percent, down from 8.6 percent in March. Year-over-year core CPI inflation also slowed, from 6.4 percent to 6.1 percent. Under the hood, the effects of the consumers' long-awaited rotation from goods to services seem to be manifesting. The price index for core commodities has stayed roughly flat since January after rising almost 12 percent during 2021. Additionally, the epic rise of used vehicle prices appears to be over. Unfortunately, inflation for non-energy services is still accelerating, gasoline prices are rising again after April's dip, and the war in Ukraine will almost surely push food prices up. As a result, headline inflation may still surprise on the upside in the months ahead.

Solid Momentum, But Sentiment Depressed

Payroll job gains, the single most important monthly economic metric, remain robust, with 428,000 job additions in both March and April. If solid job gains continue as we expect them to, payroll employment will surpass the pre-pandemic peak in late summer. New weekly unemployment claims have come up slightly since late March, but they remain at extremely low levels. Some uptick in unemployment claims is to be expected as the economy goes through the reverse of the pandemic preference shock and rotates back toward in-person services.

Light vehicle sales are rising slowly, with the January–April 2022 annualized sales pace rising to an average of 14.2 million units from a meager 12.8 million in August–December. The pace of domestic light vehicle assemblies, however, has ramped up markedly in March–April, and we expect dealer lots to start filling back up, while the sales pace trends to 16 million later this year.

The historic disconnect between the University of Michigan's Index of Consumer Sentiment and actual consumer behavior persists. The index declined by nearly 30 percent since May 2021, despite strong consumption and employment growth. The low sentiment readings suggest a risk of prompt consumer retrenchment should the economy sour.

Housing on the Precipice?

Demand for housing is showing tentative signs of an upcoming slowdown in the face of sharply higher mortgage rates. The pace of new single-family homes declined by over 12 percent between December 2021 and March 2022. The pace of existing single-family home sales likewise fell by 13 percent between January and April. Still, the pace of home sales remains above its pre-pandemic levels, homes for sale are still in short supply, and prices are still rising briskly. We think that housing has enough near-term momentum to sustain solid levels of new home construction this year. The ongoing hit to affordability, however, will slow activity in the housing sector in 2023.

In Fed We Trust

The volatile economic environment makes the Fed's job of fighting inflation while engineering a "soft landing" for the economy extremely challenging. Given data publication delays and policy transmission lags, *the Fed may have to react decisively under incomplete information, potentially producing outcomes that prove suboptimal in hindsight. Our baseline expectation, however, features the Fed successfully steering the economy to safety.*

We project the Fed to raise the target range for the federal funds rate at every remaining meeting of the FOMC this year. Consequently, the top of the range will reach 3.0 percent by early 2023 and ultimately peak at 3.5 percent. Consistent with our inflation and labor market outlooks, we expect the Fed to begin cutting rates again in 2024.

BBB Buried

The failure of the Build Back Better agenda, brisk inflation, and the likely return of divided government next year will constrain the federal government's contribution to real GDP growth. Strong growth in current nominal receipts, combined with a sizable cutback in expenditures, will lead to a swift reduction in the deficit. We project the federal deficit to drop from 13.2 percent of GDP in fiscal 2021 to 5.5 percent of GDP in 2022 and to average 4.1 percent in 2023–24.

The 2022–24 Outlook

We expect the quarterly pace of growth to rebound to 3.9 percent in 2022Q2, but then to gradually slip to 1.7 percent in 2023Q1, reflecting a general slowdown due to higher interest rates and sluggish labor supply growth. The Q4-to-Q4 growth slows markedly from 5.5 percent in 2021 to just 1.6 percent in 2023. It then rebounds to 2.2 percent in 2024, as the Fed eases policy again. While we project continued growth, some sectors and groups of households will unfortunately endure recession-like pain.

A shift in demand from goods to services, persistent rent increases, and pass-through from food and energy prices keep core inflation high through 2023. The impact of the war in Ukraine on food and energy prices contributes to headline CPI inflation running way ahead of core in 2022, clocking in at 7.8 percent. Headline inflation then converges with the core, at 3.7–3.8 percent in 2023 and 2.6–2.7 percent in 2024. By late 2023, the inflation outlook improves enough to facilitate monetary policy easing.

Payroll job gains decelerate during the rest of 2022 and 2023, falling from more than 400,000 jobs per month to just 82,000 as tighter monetary policy bites. During 2024, the pace of job gains rebounds modestly, to 124,000 jobs per month by 2024Q4. Due to the sluggish labor force recovery, the unemployment rate increases only marginally despite a marked slowdown in job growth.

The pace of light vehicle sales improves to 15.9 million units in 2022H2, with the whole year totaling 15.1 million units. Sales growth slows in 2023–24, as easing supply constraints are counteracted by slowing economic and job growth, rising interest rates, and high prices. Sales top 17 million units in 2024.

Propped up by still-rising prices and strong momentum in the multi-family housing sector, total housing starts stay above 1.7 million units in 2022. As high mortgage rates dent affordability and home price appreciation slows down, housing starts slide to 1.6 million in 2023 and 1.5 million in 2024.

	Actual	**RSQE Forecast**		
	2021	2022	2023	2024
GDP (billions of current $)	22996.1	25165.9	26727.5	27973.8
Real GDP (billions of 2012 $)	19427.3	19982.3	20393.9	20778.0
% change: year-over-year	5.7	2.9	2.1	1.9
% change: 4th-qtr-to-4th-qtr	5.5	1.9	1.6	2.2
Nonfarm payroll employment (millions)	146.1	152.1	154.6	155.7
Civilian unemployment rate (%)	5.4	3.6	3.6	3.8
Capacity utilization, total industry (%)	75.4	78.6	77.8	78.4
Inflation (private nonfarm GDP deflator, % change)	4.1	6.4	4.1	2.7
Inflation (CPI-U, % change)	4.7	7.8	3.8	2.6
Inflation (core CPI, % change)	3.6	5.5	3.7	2.7
Light vehicle sales (millions)	15.0	15.1	16.5	17.1
Private housing starts (thousands)	1604.7	1731.3	1589.8	1496.3
3-month Treasury bill rate (%)	0.0	1.6	3.2	2.9
10-year Treasury note rate (%)	1.4	2.9	3.6	3.5
Conventional mortgage rate (%)	3.0	5.0	5.5	5.2
Real disposable income (billions of chained 2012 $)	16021.3	15419.2	15727.0	16125.6
% change	2.2	-3.8	2.0	2.5
Corporate profits after tax (billions of current $)	2620.0	2402.3	2561.7	2719.1
Value of U.S. $ (FRB broad index), % appreciation	-3.9	4.4	1.6	0.0
Current account balance (NIPA basis, billions of current $)	-831.2	-1057.6	-907.8	-818.5
Federal surplus (FY, NIPA basis, billions of current $)	-2944.3	-1368.8	-1060.8	-1158.5