



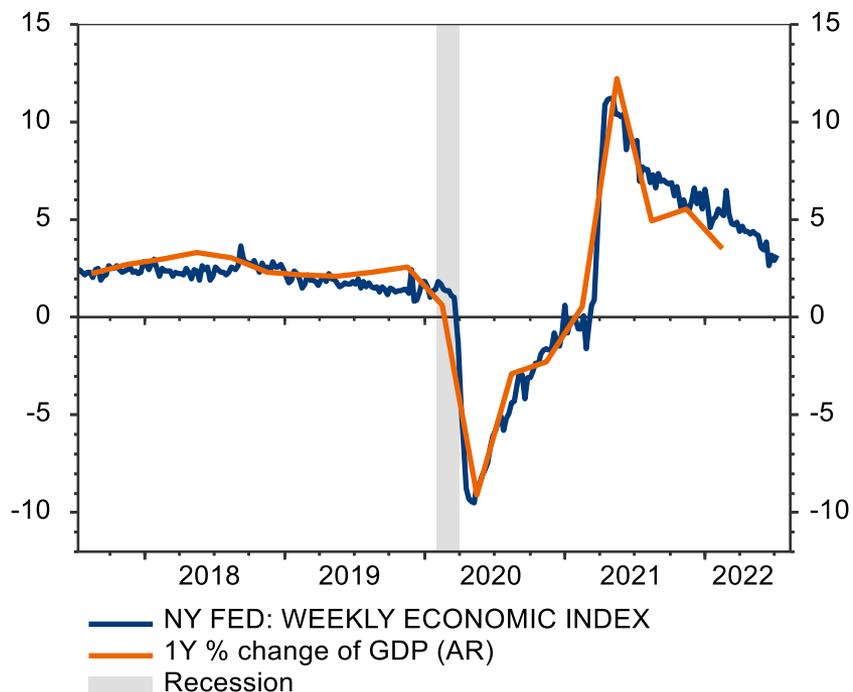
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July 2022

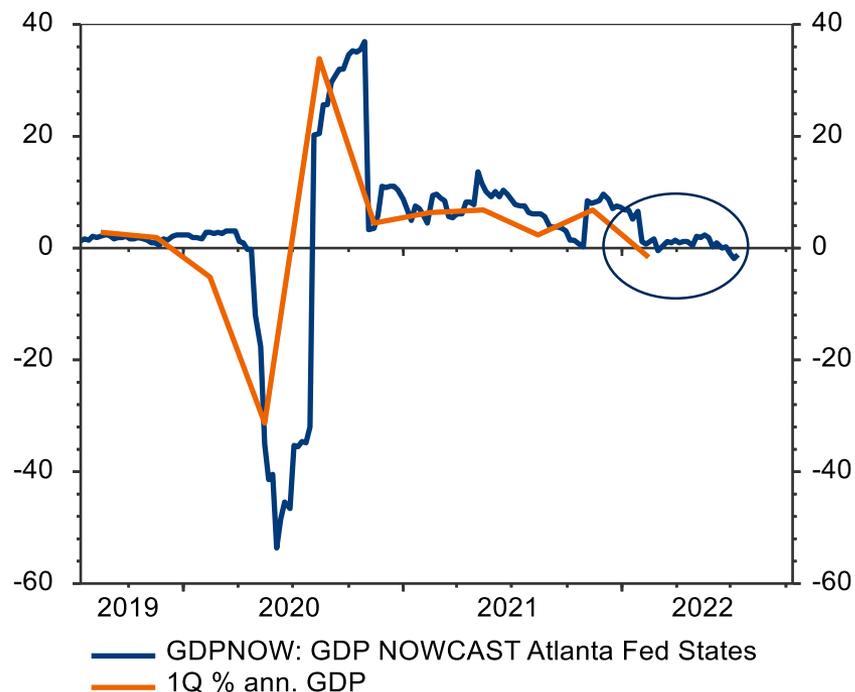
# The slowdown is already underway: how deep and long will it be?

Growth is slowing



Source: NY Fed, BEA

After a negative 1Q, GDP is flirting with another negative quarter



Source: BEA, ISM

# What is a recession?

## NBER Business Cycle Dating

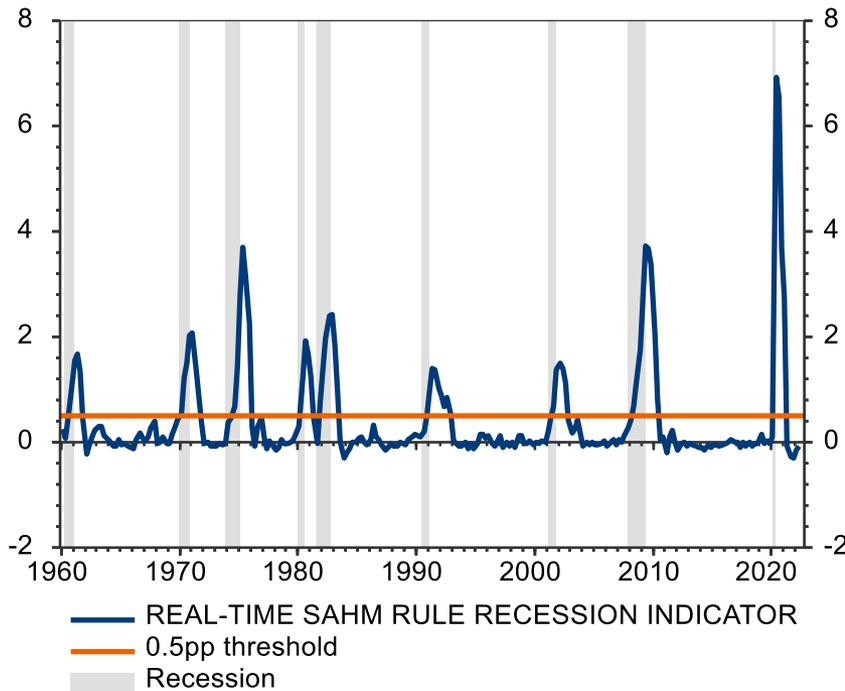
- The NBER's definition emphasizes that **a recession involves a significant decline in economic activity that is spread across the economy and lasts more than a few months.** In our interpretation of this definition, we treat the three criteria—depth, diffusion, and duration—as somewhat interchangeable. That is, while each criterion needs to be met individually to some degree, extreme conditions revealed by one criterion may partially offset weaker indications from another. For example, in the case of the February 2020 peak in economic activity, the committee concluded that the subsequent drop in activity had been so great and so widely diffused throughout the economy that, even if it proved to be quite brief, the downturn should be classified as a recession.
- Because a recession must influence the economy broadly and not be confined to one sector, the (Business Cycle dating) committee emphasizes economy-wide measures of economic activity. (...) These include real personal income less transfers, nonfarm payroll employment, employment as measured by the household survey, real personal consumption expenditures, wholesale-retail sales adjusted for price changes, and industrial production.
- There is no fixed rule about what measures contribute information to the process or how they are weighted in our decisions. In recent decades, the two measures we have put the **most weight on are real personal income less transfers** and **nonfarm payroll employment.**

*Note: our bold. Source: NBER*

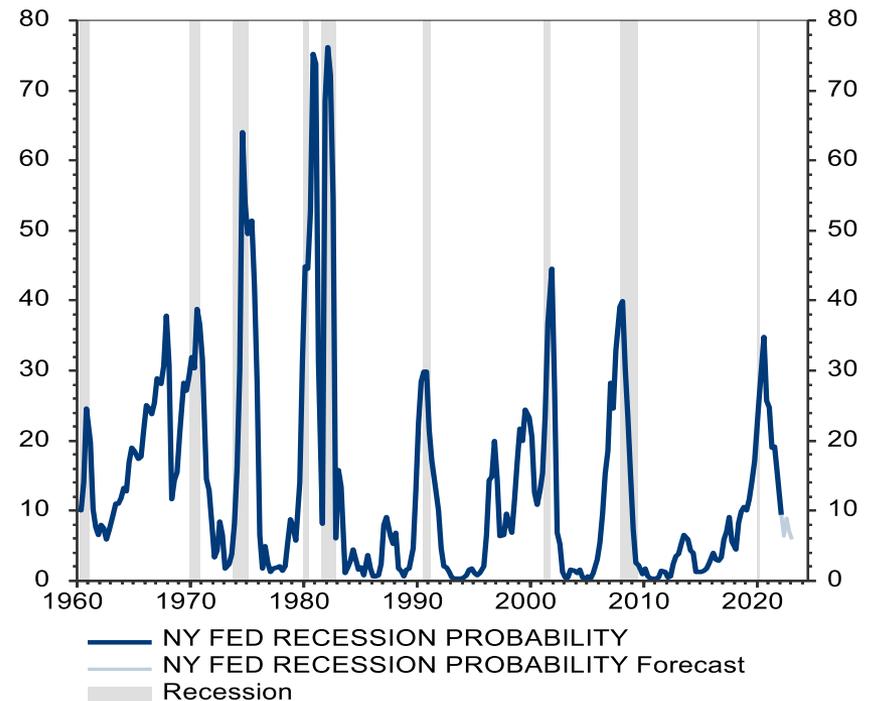
# Is this a recession?

This is not (yet) a recession, but it could become one next year

It will take a lot more economic pain to push this economy into a recession



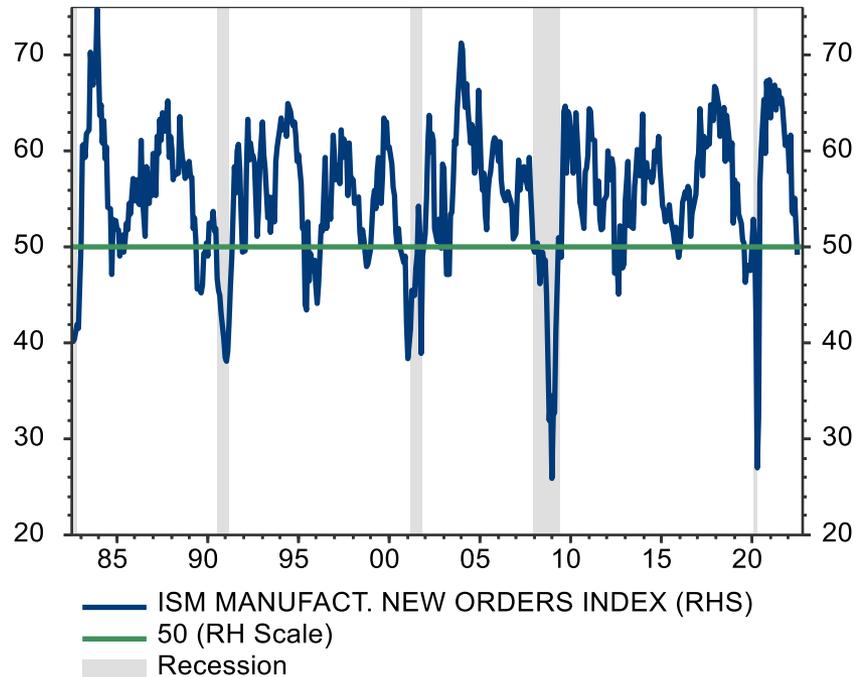
Note: Sahm Recession Indicator signals the start of a recession when the three-month moving average of the national unemployment rate rises by 0.50 percentage points or more relative to its low during the previous 12 months. Source: St Louis Fed



Note: forecast is probability 1 year ahead. Source: NY Fed

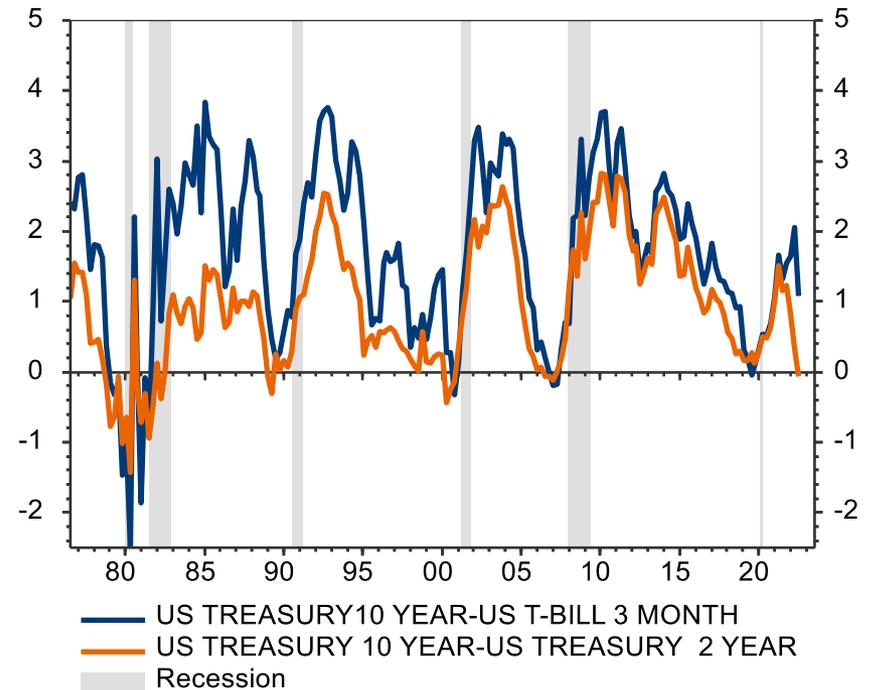
# Recession indicators are flashing yellow

ISM manufacturing orders <50 are good (not perfect!) recession predictors: June new orders fell to 49.2



Source: ISM

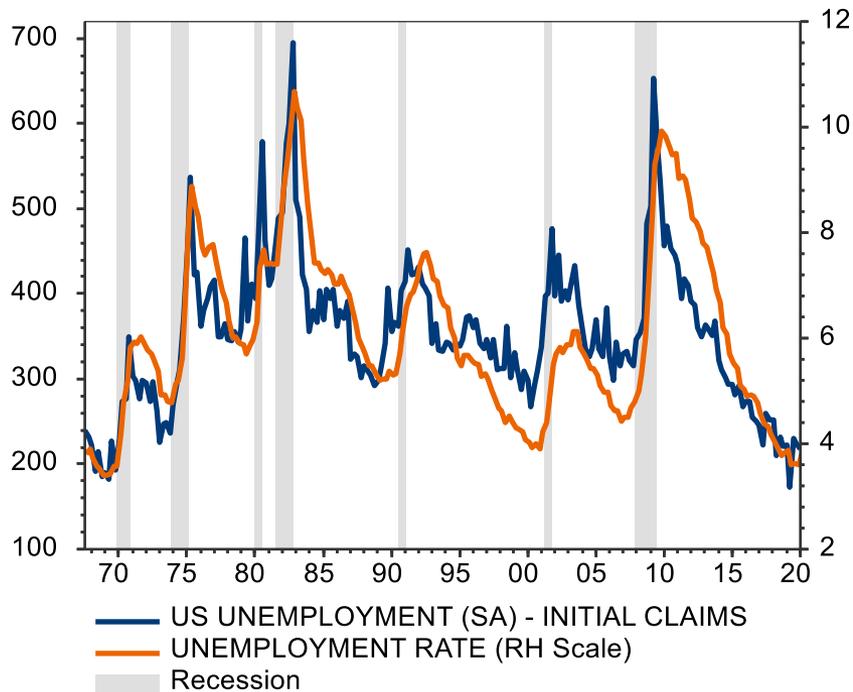
Yield curves in dangerous territory



Source: Refinitiv-Datastream

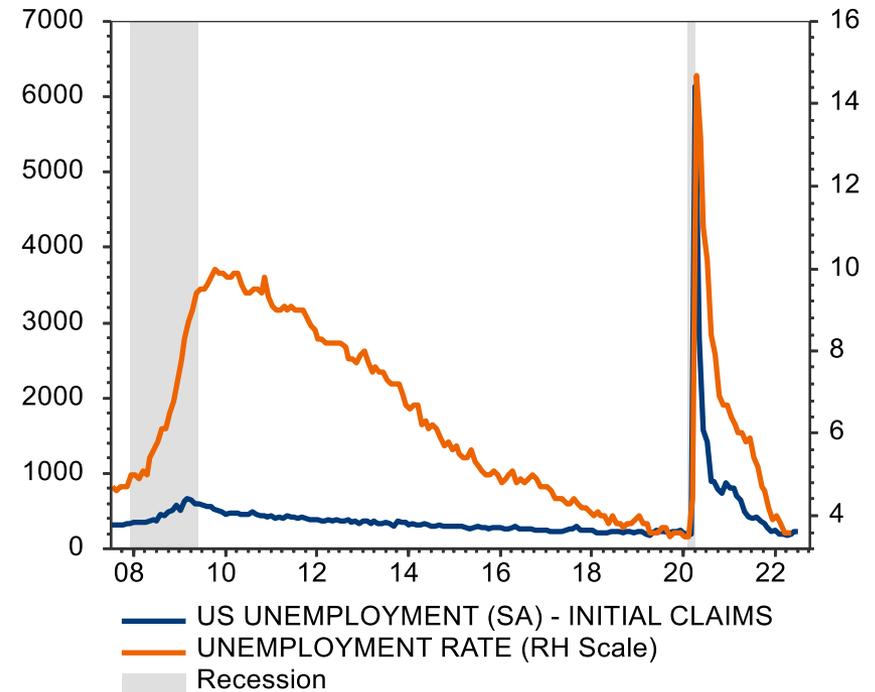
# Jobless claims are the undisputed best recession predictors: here the light is still green

Jobless claims and unemployment rate: 1967-2020 (pre-pandemic)



Source: BLS

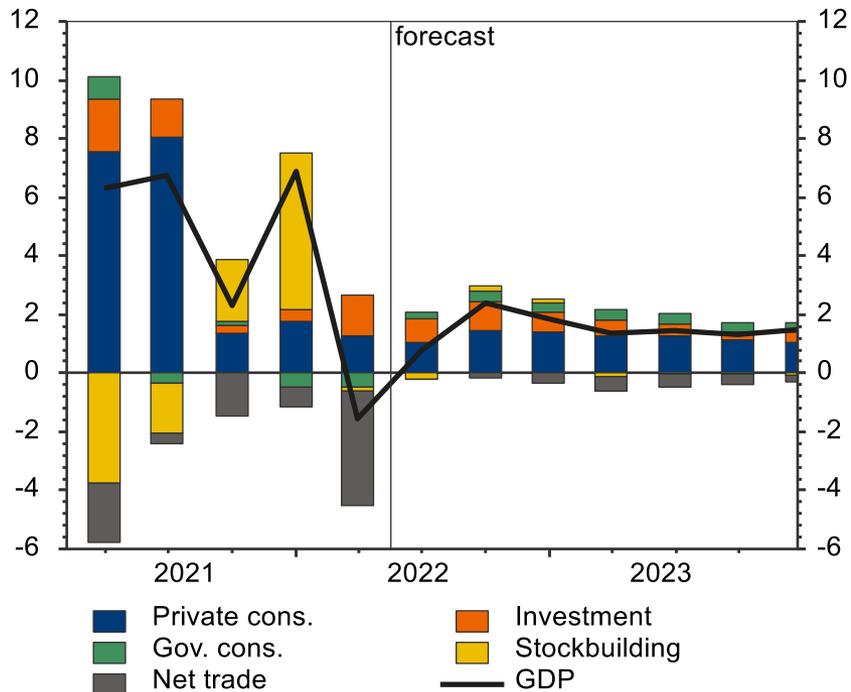
Jobless claims and unemployment rate: 2007-2022



Source: BLS

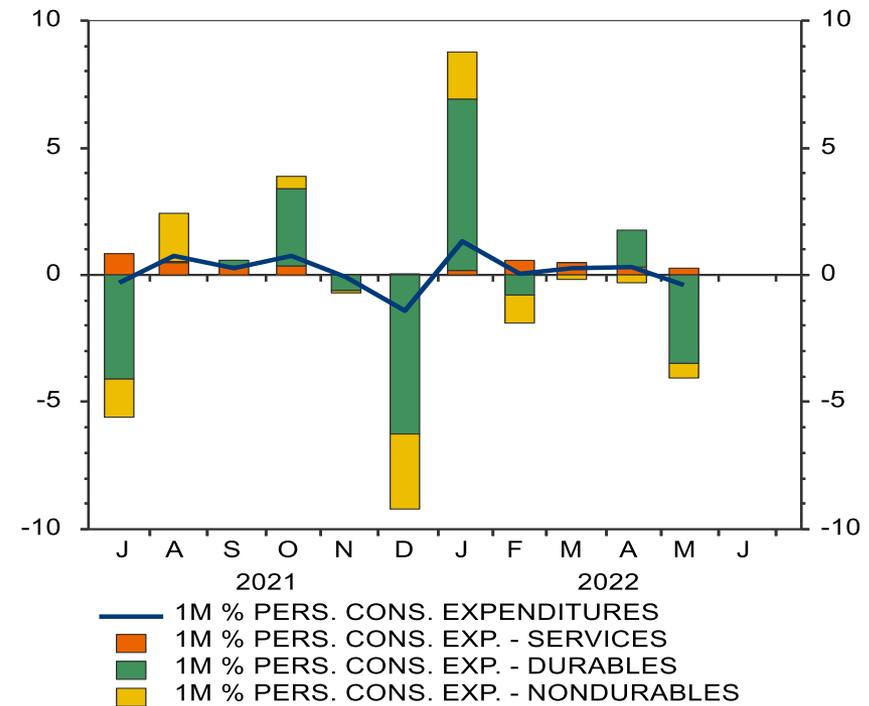
# The slowdown is here, but incomes and employment are holding up

Consumption and investment have shifted gears



Source: BEA, Intesa Sanpaolo forecasts

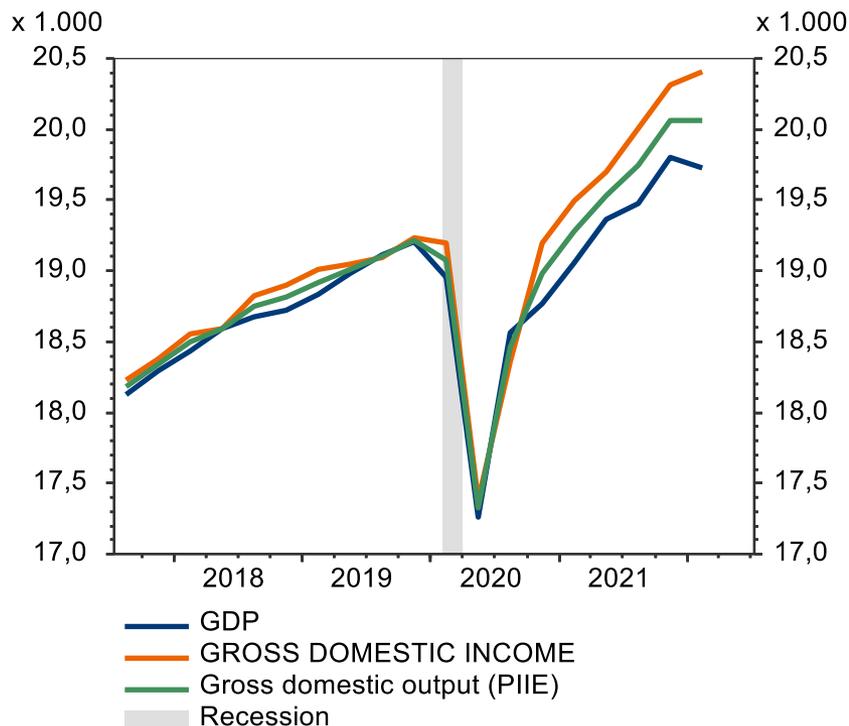
Consumption: durable goods volatility outweighs the recovery in services, in part due to vehicle shortages, in part due to demand normalization (less durable goods, more services)



Source: BEA

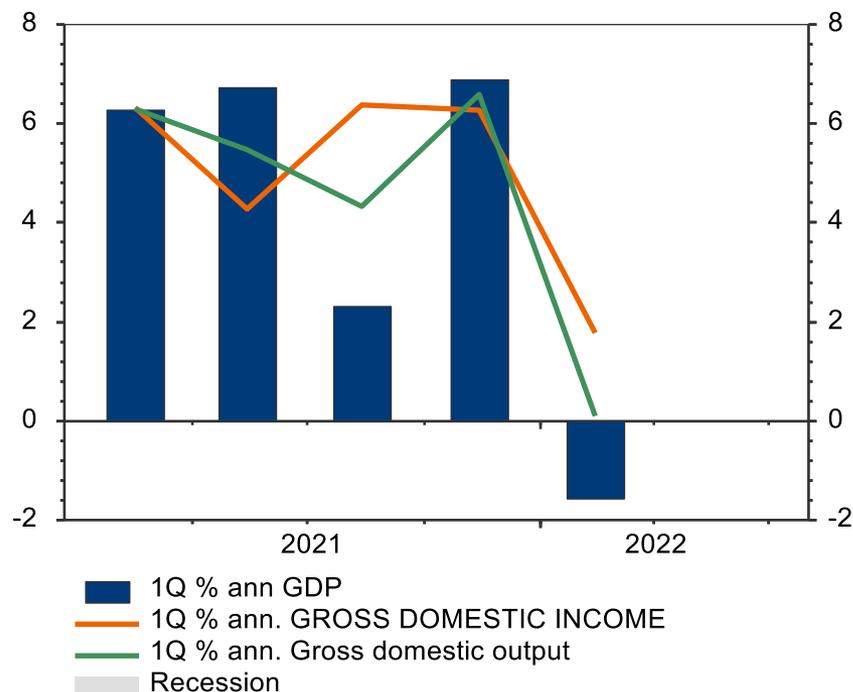
# Maybe the current weakness is overstated, but the slowdown is undisputable

GDP has been running below gross domestic income since late 2020: something has to give



Source: BEA, PIIIE

If the discrepancy between GDP and GDI closes somewhere in the middle, as has happened in the past, 1Q growth would not be negative

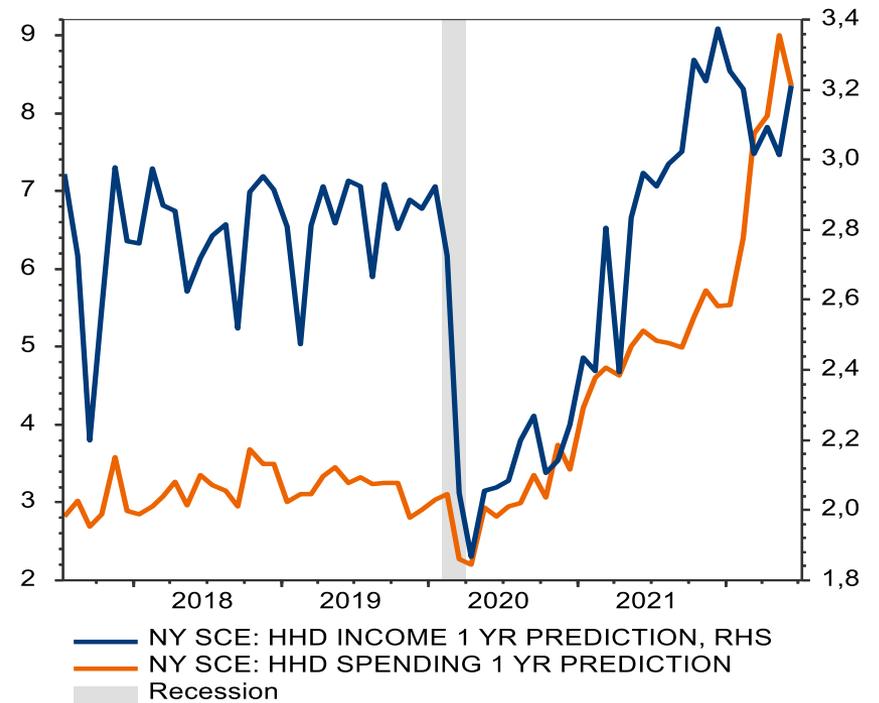
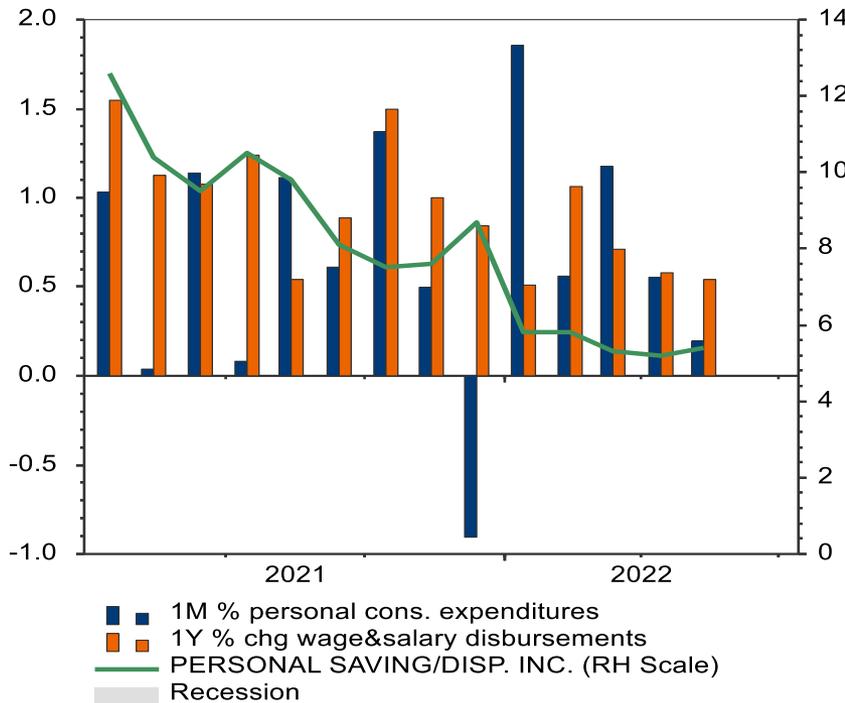


Source: BEA, PIIIE

# Higher income and pandemic savings have helped consumers cope with inflation...

Household spending financed by labor income and savings

Survey of Consumer Expectations: households expect strong spending and income growth in the next 12 months

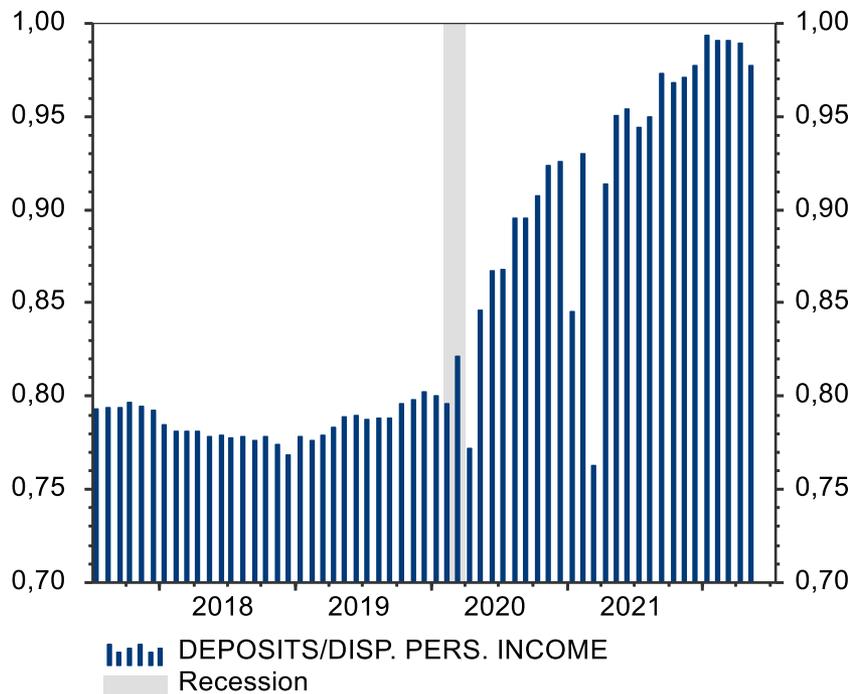


Source: BEA

Source: NY Fed, data as of June 2022

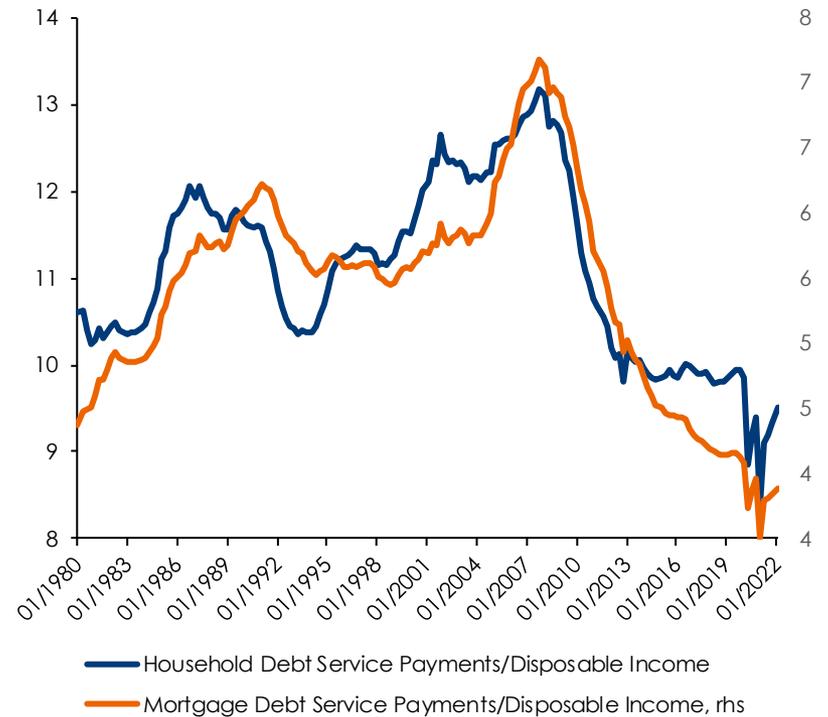
# ...and household finances are in good shape, at least for another couple of quarters

Households have accumulated deposits in excess of pre-pandemic levels and...



Source: Federal Reserve Board, BEA

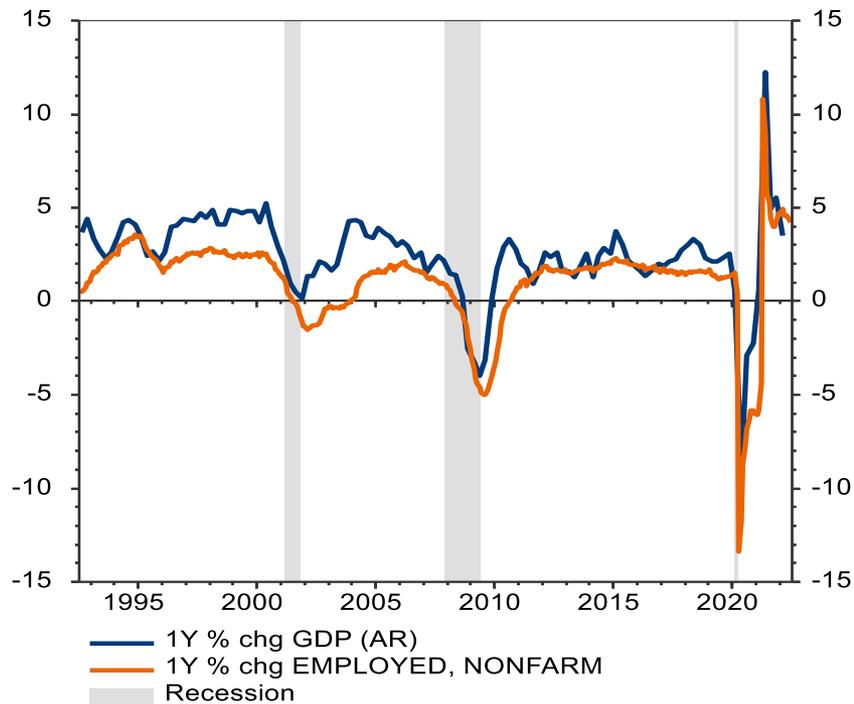
...debt service payments as a percent of disposable income are at historic lows



Source: FRED

# The labor market is still hot: record demand...

## Employment still running strong



Source: BEA, BLS

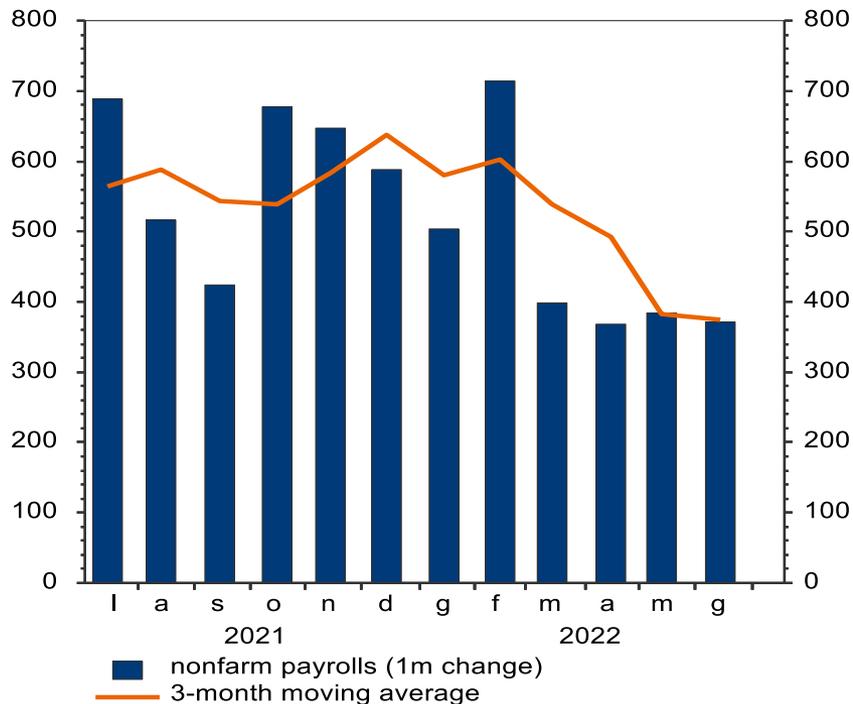
## Excess demand for labor doesn't budge: in May, 11.3 mln job openings and 1.9 job openings/unemployed



Source: BLS

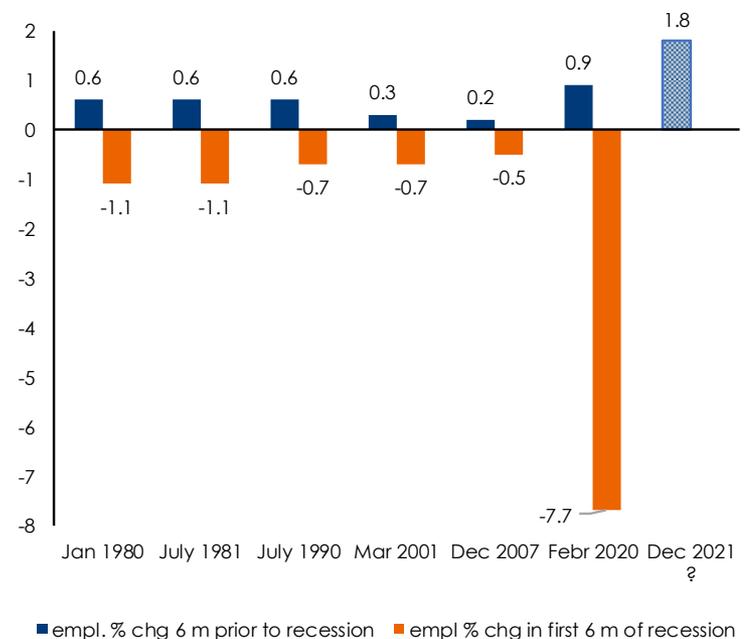
# ...with employment rolling faster than before any recession of the past 40 years...

Nonfarm payrolls rising at a brisk pace...



Source: BLS

...faster than before the past five recessions: but downturns happen fast

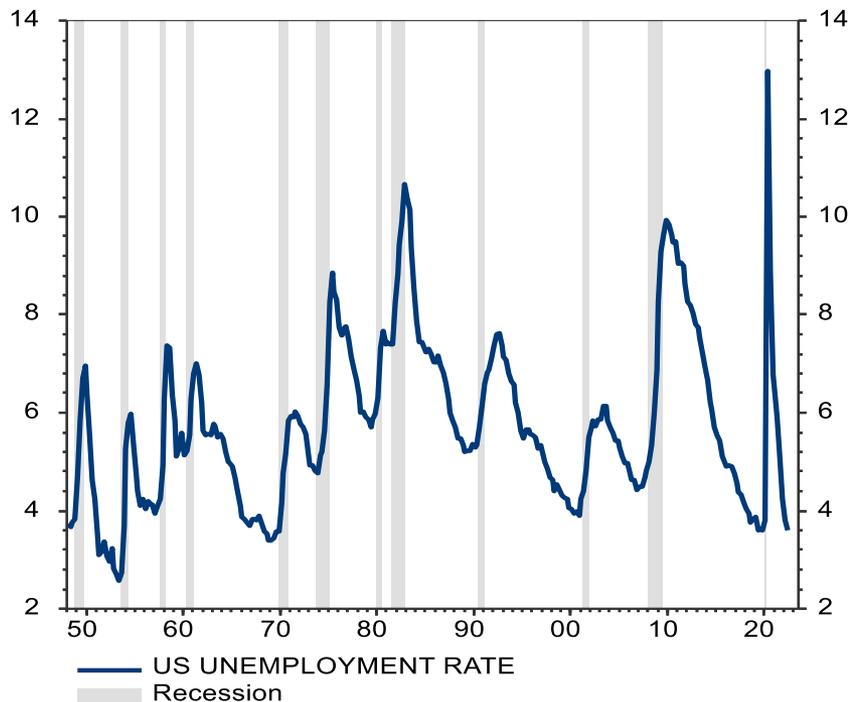


Source: BLS, NBER, PIIIE

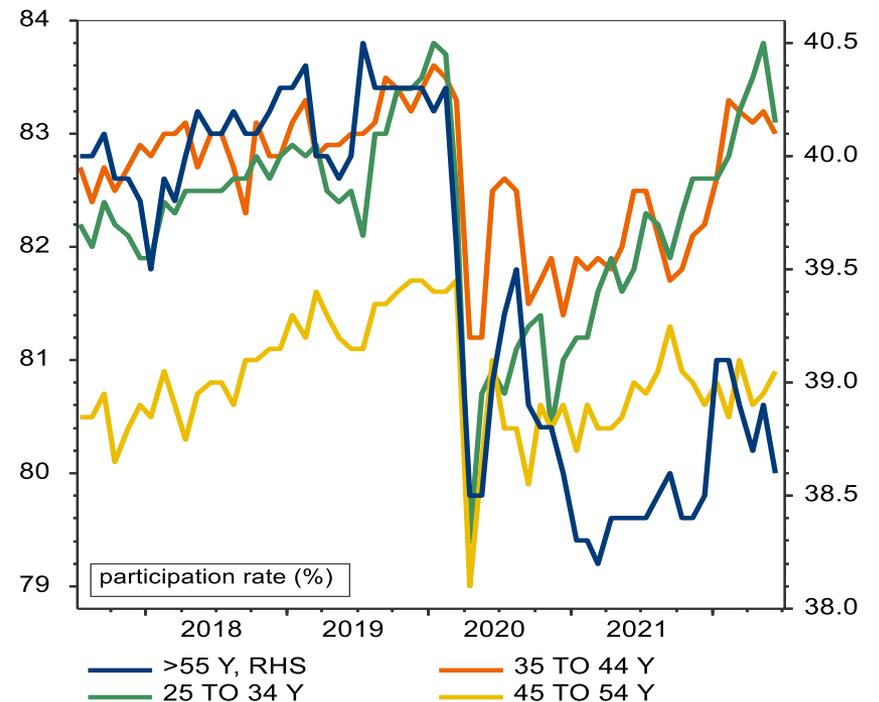
# ...in the face of persistently constrained supply

The unemployment rate is a lagging cyclical indicator, but remains below the longer term level estimated by the Fed at 4%

Participation still 1.2 pp below pre-Covid level: around 10% of non-participating individuals are out of the labor force fearing Covid



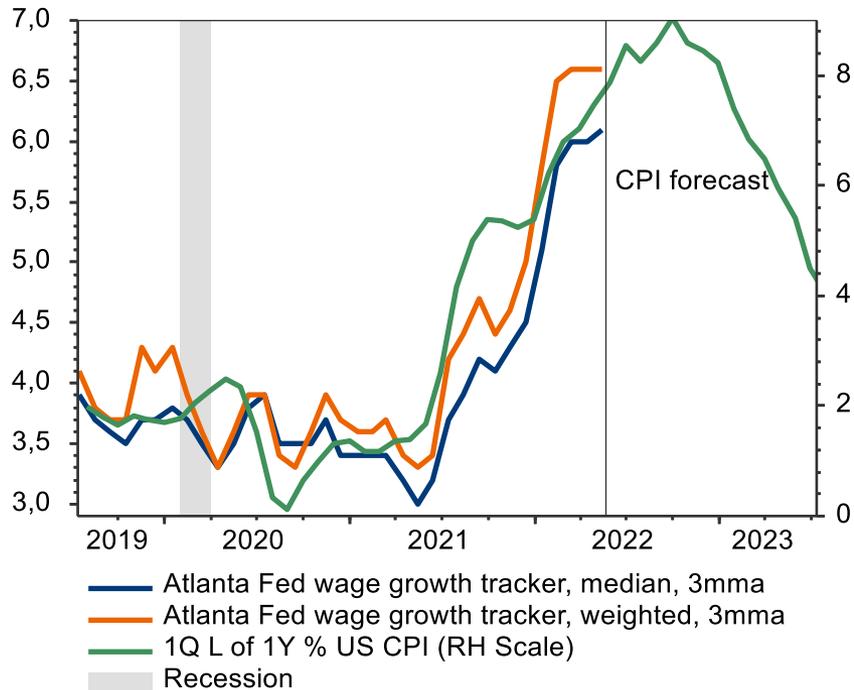
Source: BLS



Source: BLS

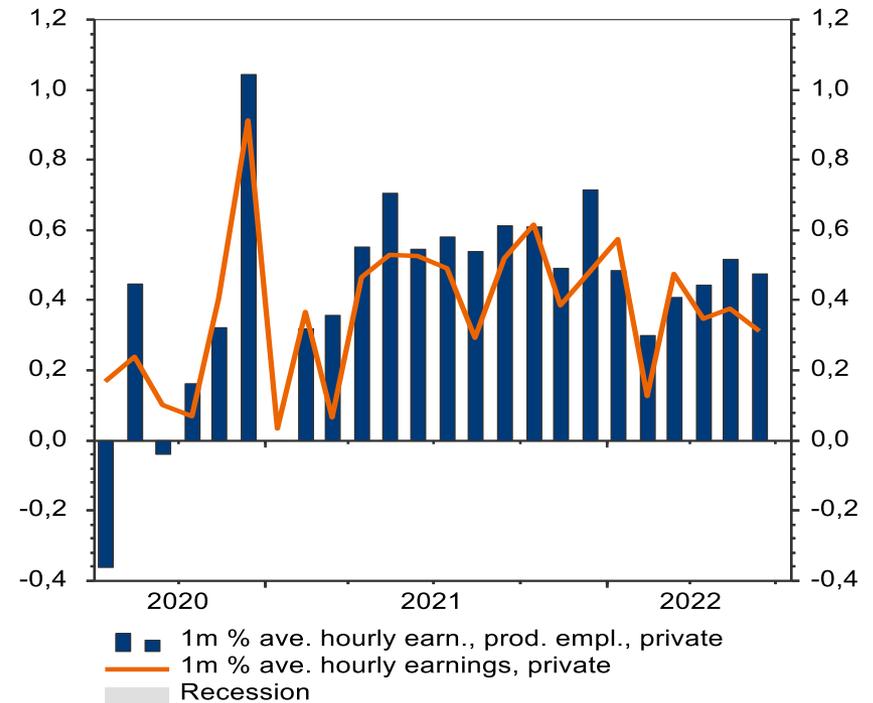
# ...pushing up wages

## Wages are chasing prices



Source: BLS, Atlanta Fed, Intesa Sanpaolo forecasts

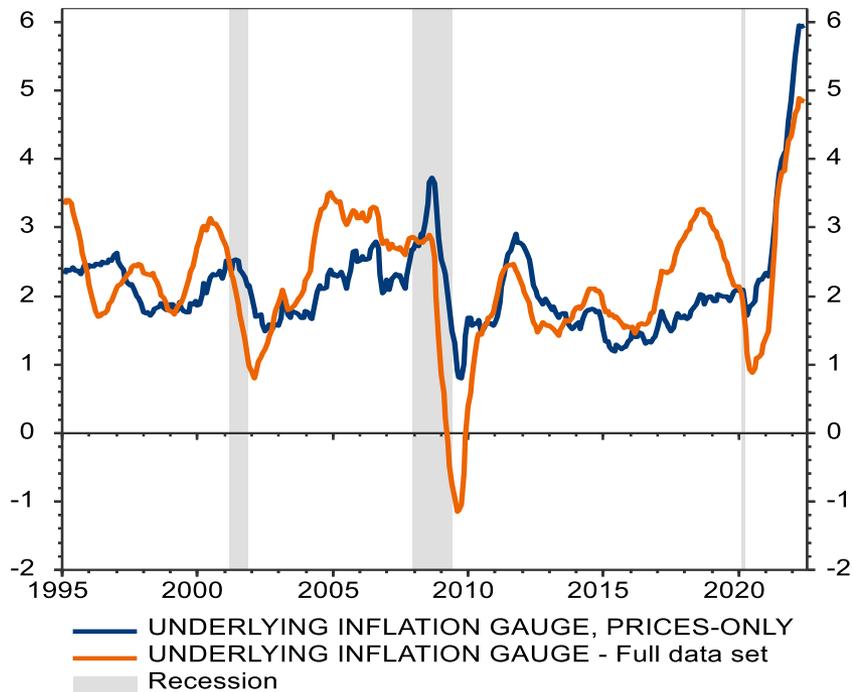
## Average hourly earnings for lower paid employees are rising fast



Source: BLS

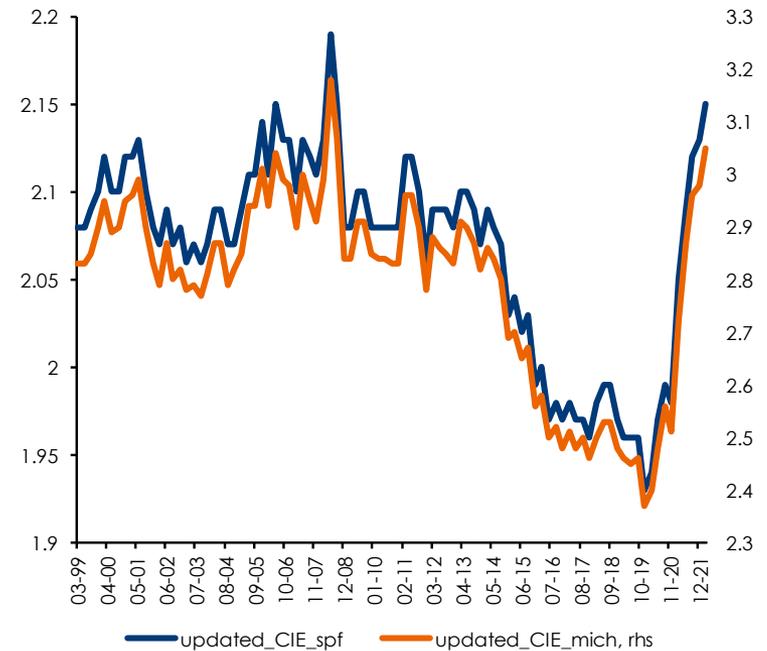
# ...in a vicious cycle that feeds back to inflation and inflation expectations

## Underlying Inflation Gauge



Source: NY Fed

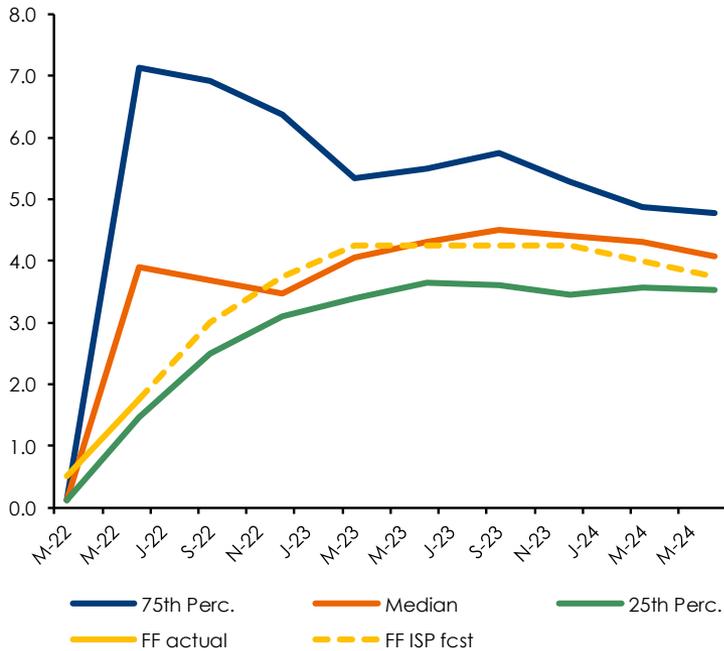
## Common inflation expectations index: the Fed is worried by the unanchoring of inflation expectations



Source: Federal Reserve Board

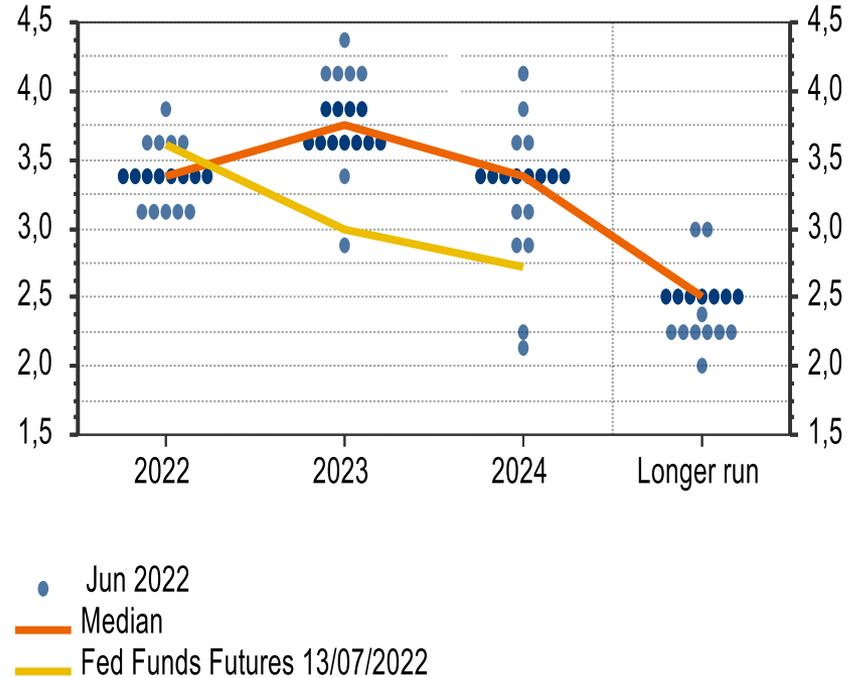
# A tug of war between inflation and recession risks: stay tuned!

Everybody at the Fed agrees that monetary policy must enter into restrictive territory and slow demand



Note: Chart shows fed funds rates estimated using 7 different monetary policy rules and forecasts for macro variables from 3 different forecasters (CBO, Survey of Professional Forecasters and Cleveland Fed).  
Source: Cleveland Fed

The market bets recession risks will dominate soon, even if inflation doesn't have time to slow in a «compelling» way

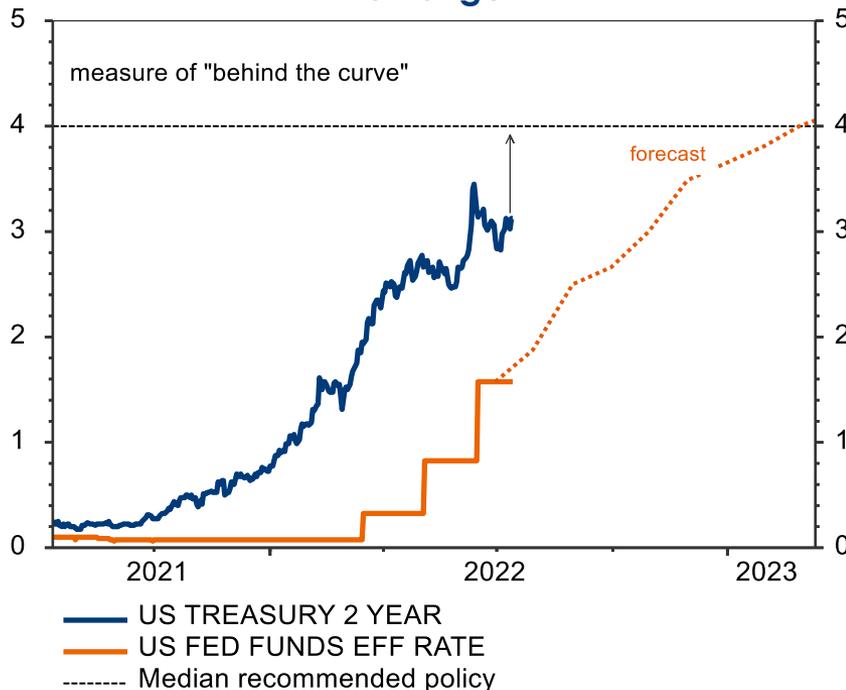


Source: Federal Reserve Board, Refinitiv Datastream

# The Fed has chosen: inflation is its only compass now

“What we’re looking for is compelling evidence that inflationary pressures are abating and that inflation is moving back down. And we’d like to see that in the form of a series of declining monthly inflation readings. That’s what we’re looking for.” (J. Powell, 15.06.2022)

**The Fed is behind the curve and must run: the data keep driving the Fed’s speed, increasing the chances for larger rate hike for longer**



Source: Cleveland Fed, Refinitiv Datastream

**Credibility and commitment matter for the outcome of monetary tightening**

- Inflation is comparable to 1974 and 1983.
- The 1974 FOMC kept the policy rate relatively low in the face of rising inflation. The associated ex-post real interest rate was relatively low. Core PCE inflation was above 5.2% for nearly 10 years and the real economy was also volatile with multiple recessions.
- The 1983 FOMC had a different approach to monetary policy and kept the policy rate relatively high in the face of declining inflation. The associated ex-post real interest rate was relatively high. Core PCE inflation was below 5.2% for the next 10 years and the real economy also stabilized with no recession until 1990-91

Source: J. Bullard, St Louis Fed

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