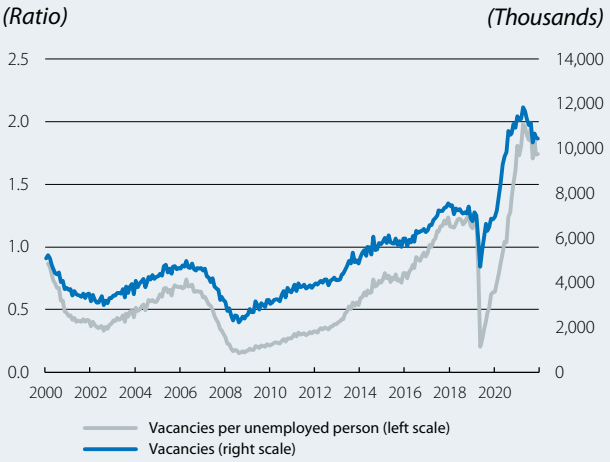
US: land as best you can

Despite the positive growth data for Q4 2022, more than half of the analysts on the Bloomberg consensus panel believe that in 2023 we will see a fall in US GDP for two consecutive quarters. Also, the probability they assign to a recession in the US in the next 12 months is around 70% and the sovereign yield curve has been inverted in the section spanning from three months to 10 years since October 2022 – an almost infallible predictor of recession. What arguments support this pessimistic view of a hard landing for US economic activity? Are there any reasons to think it is possible to avoid a recession and make a soft landing?

The US is not yet in recession

The most recent economic data do not show an economy in recession, although all the indicators, especially those most closely associated with the perceptions of economic agents, reflect a widespread downward trend. For instance, the PMI and ISM indices lie below the 50-point threshold which separates levels compatible with economic expansion from those associated with a contraction in activity. Similarly, consumer confidence indicators are at very low levels (for example, the University of Michigan Consumer Sentiment Index is below the levels recorded during the pandemic and, in June 2022, recorded the lowest level since 1978). The indicators for industrial production and retail sales, meanwhile, paint a less pessimistic picture with year-on-year changes slightly above the historical average, albeit with a downward trend. On the other hand, the labour market is not only showing no signs of weakness, but it is at saturation levels – for some indicators at levels not seen before. For instance, for every unemployed person there are currently 1.7 job vacancies, and this ratio reached close to 2 in April last year, well above the historical average of 0.64. The unemployment rate, meanwhile, stands at an all-time low of 3.5% and the rate of job creation is somewhat higher than the average for 2015-2019, although it has moderated. Thus, taking into account this combination of indicators, can we say that the US is in recession? Recently,[1] we explained that a recession is understood as a significant reduction in economic activity that is widespread across various areas of the economy and is relatively prolonged in time. Another common (although incomplete) definition is that a technical recession ocurres when there are two consecutive quarters of contractions in GDP. If we follow the second definition, we could conclude that the US was already in a recession in 2022, and we would not rule out that it could do so again in 2023. However, with the first definition, which is the one used by the NBER, we cannot state that the US entered a recession in 2022 nor that it is at risk of approaching such a situation in the short term.

US: job vacancies



Source: *CaixaBank Research, based on data from the Bureau of Labor Statistics.*

US: main economic activity indicators

	December 2022	November 2022	October 2022	September 2022	Average for 2015-2019	Average during financial crisis (2008-2009)	Average during COVID (March-December 2020)
Retail sales (% YoY)	6.0	6.0	8.0	8.4	3.5	–4.2	–0.3
Industrial production (% YoY)	1.7	2.2	3.4	5.0	0.1	–7.3	–8.1
Conference Board - Consumer confidence (index)	108.3	101.4	102.2	107.8	115.3	51.6	94.9
University of Michigan - Consumer sentiment (index) *	64.6	59.7	56.8	59.9	95.2	65.0	77.8
University of Michigan - Consumer expectations (index) *	62.0	59.9	55.6	56.2	85.6	60.7	72.2
ISM manufacturing (index)	48.4	49.0	50.2	50.9	54.0	46.8	52.8
ISM services (index)	49.6	56.5	54.4	56.7	56.7	46.8	53.9
Unemployment rate (%)	3.5	3.6	3.7	3.5	4.4	7.5	9.0
Job creation (thousands of workers)	223.0	256.0	263.0	269.0	190.2	–358.5	–1,000.7

Note: ** Data corresponding to the month after the one indicated.*
Source: *CaixaBank Research, based on data from Bloomberg.*

1. See the Focus «US: in recession?» in the MR09/2022.

The headwinds for 2023

What supports the pessimistic view held by the consensus of analysts? Firstly, the cycle of monetary tightening carried out by the Federal Reserve in 2022 has been of an intensity not seen since the 1980s. The rise in interest rates, together with the process of reducing the size of its balance sheet, will have a major impact on economic activity. Specifically, it is estimated that for every 100-bp increase in official interest rates, GDP after four quarters is reduced by almost 0.5 pps.[2] Thus, the increase in rates observed to date, and which will continue in Q1 2023, could deduct more than 2 pps from US GDP in 2023. This effect is already visible in the component of GDP that is most sensitive to interest rates, namely residential investment.[3]

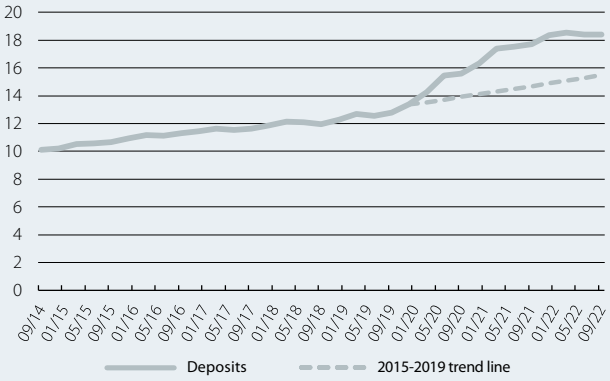
Another headwind for the US is the fall in confidence indicators which we mentioned earlier and the scenario of permanent uncertainty into which the global economy, including the US, has settled. Although the drop in these confidence and expectations indicators does not directly imply a contraction in economic activity, it does give us an indication that households and firms may be more cautious in their actions and, for example, postpone investment and consumption decisions. Finally, the US is not immune to global dynamics. Indeed, these headwinds are not only limited to the other side of the Atlantic. The economic slowdown is global in nature, so US foreign demand may lack the strength to offset the burdens that are weighing down domestic demand.

Will the tailwinds be strong enough?

In this context, the reasons to be optimistic about the US economy may be fewer, but they are still present. The main one is private consumption, which we expect will be able to make a positive contribution to GDP during 2023. This is especially important in the case of the US, as private consumption is the main driver of the economy, accounting for some 70% of GDP (in the euro area it represents around 50%, while in China it is less than 40%). This resilience which we forecast is based on two assumptions: the strength of the labour market and the savings accumulated during the pandemic. The first factor is the key assumption and it is shared by various members of the Federal Reserve. According to their estimates published in the latest macroeconomic table, which coincide with ours in many respects, the rebound in the unemployment rate ought to be limited. This is because of the significant mismatch which currently exists between the supply and demand for employment; there are still many job vacancies,[4] so it is reasonable to assume that some of the workers who would potentially lose their jobs in an environment marked by a slowdown and rising interest rates could find other jobs.

US: household deposits

(USD trillions)



Note: *The dashed line shows the trend in deposits which would have occurred assuming that the average growth observed between 2015 and 2019 had continued from Q1 2020 onwards.*
Source: *CaixaBank Research, based on data from the Federal Reserve.*

The other factor – the pent-up savings – could act as a buffer for the reduction in households' purchasing power. As we saw in a recent article,[5] households accumulated savings up to 12% of GDP and, according to the latest estimates, they have not yet consumed 60% of that amount. While these savings are certainly not likely to be evenly distributed among the various income percentiles, whose propensity to consume differs, and that a portion of the savings are held in assets that are not highly liquid or which may have even suffered losses due to the fluctuations in the financial markets, some support can still be offered to private consumption. In particular, we estimate that US household deposits are 18% higher than they would have been were it not for the pandemic (they were 23% higher at one point, but the lower savings rate recorded in the closing weeks of 2022 has begun to drain deposits).

The current scenario is challenging, and this will continue to be the case during 2023. There are many uncertainties which we await to see how they will unfold this year, including the inflationary pressures and financial conditions. If, as we believe, inflation continues to decline but remains still at high levels, its influence as a headwind could fade compared to 2022. Also, the easing of financial conditions (for example, the sovereign 10-year interest rate and the interest rate on a standard 30-year mortgage have fallen by around 70 bps and 90 bps, respectively, since their peaks in Q4 2022) also indicates that this headwind could blow less strongly in 2023. We will see whether these elements, together with the strength of the labour market and the significant pent-up savings, help to cushion a potential hard landing.

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2. See J. Rush (2021). «Bloomberg Economics Forecast Models for the U.S., U.K. and Euro Area». Bloomberg.
3. The residential investment component, which mainly reflects trends in the real estate market, has accentuated its fall in 2022, although investment as a whole continued to grow in 2022 thanks to the rest of the subcomponents (investment in capital goods, structures and intellectual property).
4. More than 10 million, in fact, while the average since 2000 is slightly less than half this figure.
5. See the Focus «US: how can the accumulated savings support the economy?» in the MR07/2022.