Visa Business and Economic Insights

U.S. Economic Outlook: Special Edition

Reaching the tipping point

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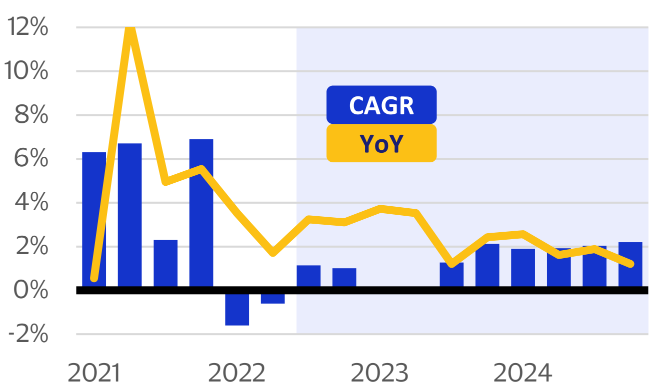
Over the course of the last few months, we have pointed out the growing downside risk to our economic outlook. Economic data flow over the last few weeks continues to reflect softer economic growth. The first disappointing data point since our last forecast update was the August Consumer Price Index (CPI) data, which showed more sustained and broad-based inflation pressure than we anticipated. The Producer Price Index, which helps foretell the future path of the CPI data, also showed continued inflation pressures. In response, the Federal Reserve enacted a third 75 basis-point hike to the federal funds rate and reinforced its commitment to hiking rates further in order to get inflation under control, which may have adverse effects on the economy. Retail sales data for the month of August was also disappointing, with core retail sales flat for the month and sharply revised downward for July. After assessing several leading economic indicators and adding them to our most trusted recession probability model, the probability of a downturn within the next 12 months has increased to 64 percent. While it is not a certainty, the risks to growth are tilted to the downside.

Our model results suggest a possible contraction in economic activity early next year. We also downgraded our assessment of GDP growth through the rest of this year and lifted our outlook for inflation, which resulted in real inflation-adjusted income remaining negative until the first quarter of 2024, a full year later than our last forecast. The contraction in real income growth will weigh on consumer spending growth in the first two quarters of next year, while business investment slows in step with higher borrowing costs. Corporate profits are expected to come under pressure as aggregate demand slows, thus leading to layoffs and upward pressure on the unemployment rate. With these changes, we now expect GDP to expand by 1.6 percent this year and just 0.5 percent next year before a recovery takes hold in 2024 with GDP growth of 1.8 percent.

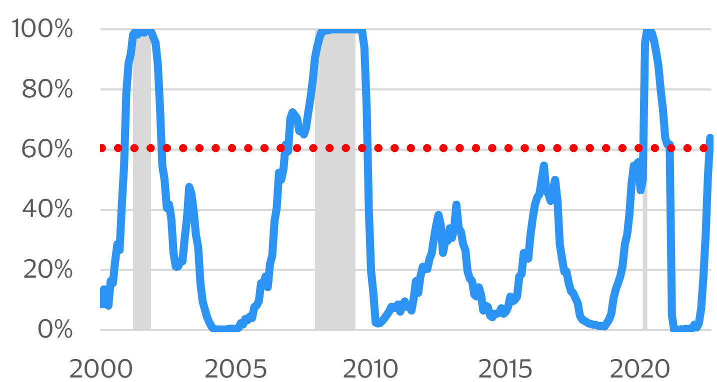
Key Points:

- Recession in 2023 is now more likely
- Modest impact to the consumer sector expected
- More downside risks remain

Fig. 1 Real gross domestic product (GDP)
(SA, CAGR and YoY* percent change)



Probability of recession in next 12 months
(Percent)



*Seasonally adjusted (SA), compound annualized growth rate (CAGR), year-over-year (YoY).
Sources: Visa Business and Economic Insights, U.S. Department of Commerce, and The Conference Board.

Reaching the tipping point

Impact of a downturn on the consumer sector

One of the key aspects of our updated outlook is that a downturn in 2023, should it occur, is likely to be minimally disruptive to the consumer sector. The ongoing tight labor market conditions and recent experience of firms struggling to find and retain workers will likely help mitigate large job losses. We expect employment to contract just 1.1 percent, on a YoY basis in 2023, significantly less than both the financial crisis and pandemic recessions. The unemployment rate is expected to rise to 5.5 percent by the end of 2023 before quickly coming back down in early 2024.

The combination of job losses and high inflation for longer will keep real disposable income growth negative until the first quarter of 2024. This loss of purchasing power and an expected slide in consumer confidence will likely slow real consumer spending growth to 0.8 percent next year before returning to its longer-run average of 2.1 percent in 2024. Higher inflation rates, however, will keep nominal consumer spending growth relatively stable. We expect nominal spending to rise 4.1 percent next year and 4.2 percent in 2024.

Inflation pressures should finally be tamed by slower demand and the Fed's rate hikes, but the process will take some time. We expect the PCE deflator (the Fed's preferred inflation gauge) to fall from 5.1 percent in the fourth quarter of this year to 1.9 percent by the second quarter of 2024. This gradual process will likely keep the Fed in an aggressive stance of rate hikes for a bit longer.

More large rate hikes likely needed

At its September meeting, the Fed hiked rates by another 75 basis points, the third such hike in a row to combat inflation. While we expect inflation to remain elevated, our view is that the Fed will downshift to 50 basis point hikes in November and assess the cumulative effects of its hikes on the economy. We expect another 50 basis point hike in December before the Fed downshifts to a 25 basis-point hike early in 2023. Our view is that the terminal (peak) federal funds rate of 4.5 percent will be reached in the first quarter of next year. We then expect the Fed to begin cutting rates by 25 basis points per meeting beginning in the third quarter of next year, gradually returning the funds rate to the long-run neutral rate of 2.5 percent by the end of 2024. With the new path for the funds rate, we expect the benchmark 10-year Treasury likely peaked in Q3 of this year and should slowly edge back down through the end of our forecast horizon.

Risks to the outlook

With our downward revisions in this update, some downside risks remain, namely the possibility that inflation stays higher than expected under our new outlook. The recent spike in interest rates is also beginning to create some stress in the corporate bond market, which has the potential to spill over to the economy, slowing growth relative to our baseline forecast. There are, however, also some upside risks that may materialize, including fewer job losses and a faster decline in inflation than expected as other economies around the world also slow.

	Actual		Forecast						Actual	Forecast		
	2022				2023				2021	2022	2023	2024
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
Gross Domestic Product (CAGR)	-1.6	-0.6	1.1	1.0	-0.1	-0.1	1.3	2.1	5.7	1.6	0.5	1.8
Personal Consumption	1.8	1.5	1.3	1.2	-0.1	-0.1	1.6	2.6	7.9	2.4	0.8	2.1
Business Fixed Investment	10.0	0.0	5.3	1.4	-4.2	-2.4	0.0	-0.7	7.4	4.5	-0.7	1.0
Equipment	14.1	-2.7	3.8	0.4	-7.5	-4.5	-0.7	1.1	13.1	4.3	-2.4	2.2
Intellectual Property Products	11.2	10.0	7.9	3.5	-1.3	-0.8	0.8	1.3	10.0	9.4	1.9	2.4
Structures	-0.9	-13.2	-5.9	-1.8	-1.9	-0.3	0.1	-12.0	-8.0	-5.9	-3.3	-7.0
Residential Construction	0.4	-16.2	-27.6	-8.6	-10.0	-8.6	0.3	0.8	9.2	-8.6	-10.6	0.6
Government Purchases	-2.9	-1.8	-0.7	-0.8	-0.4	-0.3	-0.2	0.3	0.5	-1.7	-0.5	0.4
Net Exports Contribution to Growth (%)	-3.2	1.4	1.6	0.4	1.2	0.8	-0.5	0.1	-1.4	-0.8	0.8	-0.1
Inventory Change Contribution to Growth (%)	-0.4	-1.8	-0.6	-0.1	-0.3	-0.2	0.6	0.2	0.4	0.6	-0.2	0.1
Nominal Personal Consumption (YoY % Chg.)	11.1	8.5	7.8	6.6	5.3	4.0	3.5	3.7	12.1	8.5	4.1	4.2
Real Personal Consumption (YoY % Chg.)	4.5	1.9	1.8	1.4	1.0	0.6	0.6	1.0	7.9	2.4	0.8	2.1
Nominal Personal Income	-2.8	4.5	5.0	4.7	3.8	1.8	0.5	0.6	7.5	2.8	1.7	2.8
Retail Sales Ex-Autos	13.6	11.2	10.2	7.7	5.4	1.9	1.2	2.2	19.1	10.6	2.6	3.8
Consumer Price Index	8.0	8.6	8.2	7.2	5.7	3.8	3.5	3.3	4.7	8.0	4.1	2.4
Federal Funds Rate (Upper Bound)	0.50	1.75	3.25	4.25	4.50	4.50	4.00	3.50	0.25	2.44	4.13	2.88
Prime Rate	3.50	4.75	6.25	7.25	7.50	7.50	7.00	6.50	3.25	5.44	7.13	5.88
10-Year Treasury Yield	2.32	2.98	3.73	3.68	3.65	3.63	3.61	3.55	1.45	3.18	3.61	3.45

Forecast as of: September 29, 2022

Interest rates presented are end of quarter rates

Note: Annual numbers represent year-over-year percent changes and annual averages

Sources: Visa Business and Economic Insights, U.S. Department of Commerce, U.S. Department of Labor and Federal Reserve Board.

Forward Looking Statements

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