Global Economic Research

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A Balance Sheet For The U.S. Economy

A path remains in sight for the U.S. to avoid a recession.

By Carl Tannenbaum

It is said that life is a marathon and not a sprint. If so, Eliud Kipchoge has led a life well-lived. Last Sunday, the peerless Kipchoge set a world record in the marathon, cementing his reputation as the best of all time at that distance.

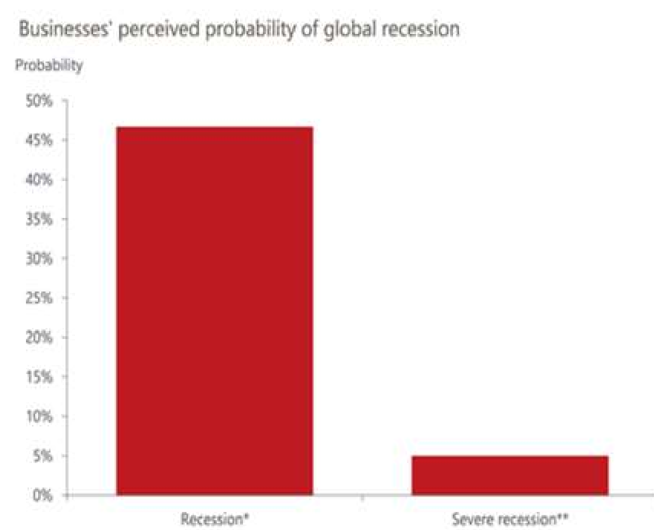
Economic and market performance is best measured over long intervals, as well. That hasn't been the easiest perspective to maintain, as the pandemic (and the associated policy response) has produced a series of extremes in both directions. We're presently dealing with a deceleration caused by rising interest rates, wondering if activity will slow to a halt or reverse course.

The outcome will vary by location. Our updated **global economic forecast** reflects our expectation that the United Kingdom and Europe will experience a recession in the coming quarters. But we have not yet concluded that the U.S. economy will enter a downturn. Questions about our call continue to come in, so we thought it would be useful to offer a current balance sheet for the American economy.

Still no recession call for the U.S.

Liabilities

- The **housing industry** is in recession. We've experienced a 20% drop in home sales over the past year, and home prices fell last month. Both trends are likely to continue, with mortgage rates more than double what they were last January. A slowing housing market will limit the purchase of furnishings and a range of services used by homeowners.
- The **Federal Reserve** is going to raise interest rates to much higher levels than previously thought. Financial conditions are still not overly tight, and real interest rates are still negative. Fed balance sheet reductions will add to the restraint that monetary policy will place on activity.
- International markets are slowing. This will increase the American trade deficit, which is a drag on gross domestic product (GDP).
- The equity market correction will likely lead companies to diminish their demand for labor. After working hard to hold on to staff in a tight labor market (and keeping postings out for more talent), firms will have to manage costs to sustain profitability. Unemployment is unlikely to rise substantially, but increased joblessness will diminish consumption.



Sources: Haver Analytics, Oxford Economics

Assets

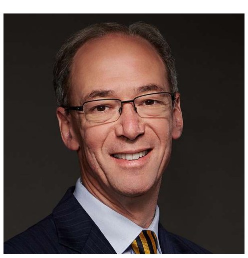
- Even if the labor market loses a little of its luster, it is still one of the strongest in many years. Wage income has grown solidly, providing a durable source of spending. There are also still pockets of pent-up pandemic saving on household balance sheets.

- Inflation is falling. It is likely that real income growth will turn positive again within the next two quarters, restoring gains in purchasing power. The retreat of energy prices is already having a favorable impact on consumer confidence.
- American manufacturers are still doing quite well, with leading indicators like the purchasing managers index (PMI) still in expansionary territory. U.S. industry will likely benefit somewhat from the growing desire for **re-shoring**.

If a downturn comes, we expect it to be shallow and short. The softening of economic activity will likely lead the Fed to conclude its interest rate increases by early next year. We do not see the **excesses of leverage** that have turned mild problems into deeper ones in the past.

Even if recession is avoided, though, American economic growth over the coming year may not be overly robust. Fiscal policy has stretched itself to extremes over the last two years, and **rising debt and interest costs** will limit the ability of governments to promote a more robust expansion.

As we enter this phase, it bears repeating that recessions are not fatal for economies and markets. They arise because of imbalances, and serve to reduce them. In their wake, markets and economies typically perform well. Best to stay focused on the long run.



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Carl Tannenbaum is the Chief Economist for Northern Trust. In this role, he briefs clients and colleagues on the economy and business conditions, prepares the bank's official economic outlook and participates in forecast surveys. He is a member of Northern Trust's investment policy committee, its capital committee, and its asset/liability management committee.