U.S. Economic Forecast: Cloudy With a Chance of Showers

U.S. economic forecasts for the coming year differ widely, but even the most optimistic predict tepid growth and lingering inflation, while many expect a recession.

The Conference Board predicts a 96% likelihood of a recession in the U.S. within the next ten months.*

Recession watchers have had a busy time of it lately. On the one hand, inflation remains high and interest rate increases are dousing the stock, bond, and housing markets. China is stumbling, and the global economy is ailing. Meanwhile, the war in Ukraine continues to pose uncertainties and anxieties across the world. On the other hand, the U.S. economy remains robust. Unemployment is low, consumer spending continues to be strong, and inflation has shown signs of moderating. The Federal Reserve has already slowed the pace of its rate hikes and hinted at a possible pause.

These mixed signals have produced a broad range of forecasts. Goldman Sachs predicts a "soft landing" with only a slight moderation in growth. S&P Global sees a "tipping toward recession." Fannie Mae and JP Morgan foresee a "mild recession." Meanwhile, economist Nouriel Roubini, who correctly predicted the 2008 financial crisis, expects a downturn that will be "severe, long, and ugly."

Barometric Pressures

Driving this wide range of forecasts is a host of different factors that will collectively determine if a recession occurs and how severe the recession might be.

Inflation and rate hikes remain the most critical determinants of how well the U.S. economy performs in 2023. As of November 30, 2022, the Consumer Price Index (CPI) was 7.7% higher than a year earlier.[1] That's down from 9.1% in June but still well above where the Federal Reserve (Fed) would like it to be. Following multiple increases in 2022, the target range for the federal funds rate now stands at 4.25% to 4.50%.

Most forecasters expect that to rise further in 2023. But Fed Chairman Jerome Powell has indicated that increases may be further moderated or even paused if inflation continues to head downward.

The housing market. After several years of unprecedented strength, residential real estate is beginning to cool, primarily due to rising rates. The average rate on a 30-year conventional mortgage more than doubled during 2022, although it has come down some in recent months. Sales volume is down, and house prices have started to drop in some areas. Most prognosticators expect a further slowdown, with wide variations depending on location and inventory. Although nobody expects the downturn to be as severe as the 2006-2011 housing bust, it still is expected to impact economic activity in the year ahead.

The war in Ukraine. In addition to the human toll the war has taken, it has also created food shortages and supply bottlenecks. Russia's reaction to sanctions is also the underlying cause for soaring energy prices and inflation in many European countries. Although the U.S. is better insulated from these effects, the uncertainty of the war will continue to be a major factor driving energy prices and financial decisions.

Chinese economic and real estate woes. China's zero-Covid policy has throttled the Chinese economy, with widespread restrictions and lockdowns. Although the government has started dismantling most of these, some remain in place as the country battles a surge in new cases. A real estate bust has also taken a toll on economic activity. Still, China's GDP is forecast to rebound in 2023, especially in the latter half of the year, as the economy further reopens. But the near-term could be bumpy, especially in light of recent protests.

Looming debt crisis. Inflation, rising interest rates, slowing growth, and a strong dollar are creating a perfect storm for many indebted developing countries. Already, about 60% of low-income countries and about 25% of emerging markets are either in debt distress or at high risk of it.[2] Although these defaults are unlikely to spur a global financial crisis, they could have a spillover effect on world financial markets.

As if these potential pitfalls weren't enough, there is also the prospect of a gridlocked Congress getting little done and the possibility of government shutdowns. Whether all these factors cause a recession, and how severe it might be, is uncertain. But clearly, 2023 promises to be a year of economic challenges.

*The Conference Board, *Probability of US Recession Spikes to 96%*, October 05, 2022.

[1]Bureau of Labor Statistics, 12-month percent change in the CPI for All Urban Consumers (CPI-U).

[2]The Guardian, *Time May be Running Out': Global Debt Crisis Reaches Critical Point*, October 13, 2022.

