U.S. Economic Outlook

Landing on a cloud

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In the month since our last outlook, the future trajectory of the U.S. economy has become more uncertain. We are confident that the economy is not in recession right now, but the odds of a recession in 2023 continue to climb. We use various recession probability models to ascertain the likelihood of a broad-based contraction. The most reliable model now shows a 50 percent chance of a downturn within the next year, still leaving a 50 percent chance that the U.S. will avoid a recession, which is encouraging. This model has a strong track record of predicting recessions when it reaches 61 percent, but it has given false signals at 50 percent, so it would need to increase substantially before we would confidently believe a recession is on the horizon.

We think the most likely outcome is a soft landing, with positive gross domestic product (GDP) growth and sustained job creation. This month we also developed our initial forecast for 2024, which conveys our expectations for the long-run growth path of the economy.

We expect GDP to expand by 1.7 percent in the third quarter of this year and 2.0 percent in the fourth quarter. These represent upward revisions from our previous forecast, based on stronger-than-expected data on consumer spending and international trade. Over the following year, we expect below-trend growth in the range of 1.6 percent to 1.9 percent, reflecting the drag from higher interest rates, a drawdown in residential construction, lower government deficits and a widening trade deficit.

We expect consumer spending to be a relative bright spot. If inflation recedes as we anticipate, real disposable personal income will turn positive next year, giving the consumer much more breathing room. We now forecast personal spending increases of 2.5 percent for the 2022 calendar year and 2.2 percent in 2023.

Key Points:

- Job growth is expected to slow down
- The housing market is in a correction
- The inflation outlook is highly uncertain

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

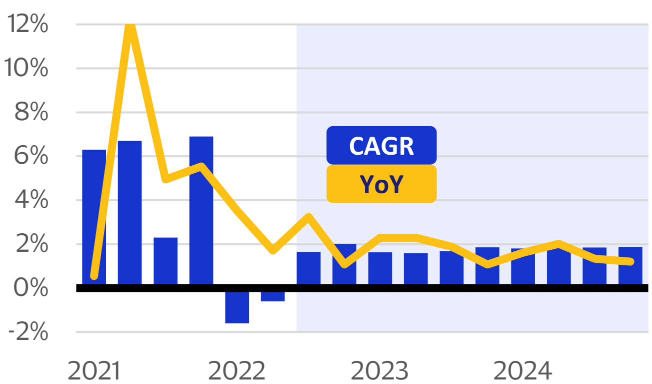
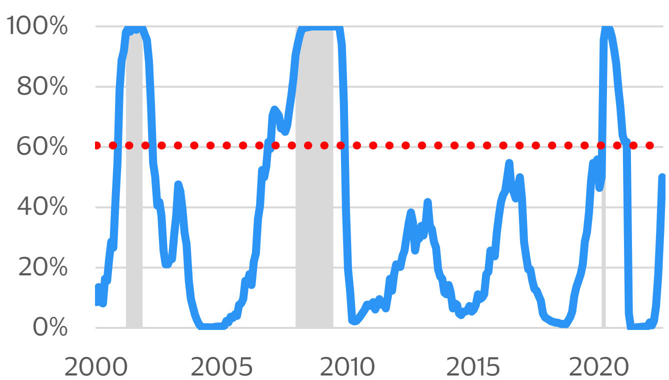


Fig. Probability of recession in next 12 months
(Percent)



*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.

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The job market is strong but slowly cooling

The economy added 315,000 jobs in August, extending a hiring streak that has led to a full employment recovery. For every two open positions there is only one unemployed individual actively looking for work, indicating that demand for talent far exceeds the available supply. The unemployment rate is near historic lows and wages are rising quickly. These are the markers of an exceptionally tight labor market with sizeable forward momentum.

Over the second half of 2022, job growth should remain robust, but the pace of hiring will slow. After an average monthly gain of 380,000 jobs in the third quarter, we expect a downshift to 265,000 jobs gained each month in the fourth quarter and 230,000 per month in early 2023. At the same time, we expect the unemployment rate to average 3.7 percent at the end of 2022, slightly higher than the 3.5 percent observed earlier in the year.

While these might sound like worrisome trends, they actually support our call for a soft landing of the U.S. economy. In order for inflation to decelerate to the Federal Reserve's 2 percent target, balance needs to be restored between supply and demand in the job market, which would ultimately reduce the pace of wage gains and prevent them from pushing inflation even higher.

The housing situation

After a large run-up in housing activity, the market is now squarely in a correction. For the 2022 calendar year, we expect approximately 5.1 million existing home sales, down sharply from 6.1 million in 2021. Sales should decline further in 2023 to approximately 4.3 million. High prices and elevated mortgage rates have made the market unaffordable for a substantial number of potential buyers.

In an environment of declining home sales, we expect construction companies to build fewer residential units, suggesting that the housing correction will be a drag on GDP. Investment in residential construction projects is expected to decline by 19 percent in the third quarter of 2022 (at a seasonally adjusted compound annual growth rate), which comes on the heels of a 16.2 percent downturn in the second quarter. We anticipate this drag to dimmish but remain persistent through the middle of next year.

Risks to the outlook

The primary uncertainties in this month's forecast are related to inflation and the Fed. At the time of this writing, we expect inflation to be stable during the second half of 2022 and to improve in 2023, allowing the Fed to maintain a federal funds rate consistent with a macroeconomic soft landing. But a number of factors could keep inflation elevated, potentially forcing the Fed to raise rates high enough to cause a recession. These factors include an unexpected spike in oil prices, another major round of supply chain disruptions, and an acceleration in wage gains, among others. The next few months of inflation data will be highly influential for the Fed, and we will undoubtedly discuss the implications in upcoming outlook reports.

	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	1.7	2.0	1.6	1.6	1.7	1.9	5.7	1.8	1.6	1.8
Personal Consumption	1.8	1.5	1.7	2.5	2.3	2.2	2.2	2.2	7.9	2.5	2.2	2.1
Business Fixed Investment	10.0	0.0	5.4	3.1	3.1	3.4	3.7	4.1	7.4	4.6	3.4	4.3
Equipment	14.1	-2.7	4.1	1.0	1.1	1.5	2.2	2.9	13.1	4.4	1.5	3.0
Intellectual Property Products	11.2	10.0	7.9	7.4	7.0	6.9	6.8	6.8	10.0	9.7	7.3	7.0
Structures	-0.9	-13.2	-6.4	-2.8	-1.9	-1.3	-0.8	-0.2	-8.0	-6.0	-3.1	0.0
Residential Construction	0.4	-16.2	-19.0	-8.2	-3.0	-1.2	0.2	0.5	9.2	-7.4	-6.2	1.0
Government Purchases	-2.9	-1.8	-0.9	-0.8	-0.7	-0.4	-0.2	0.3	0.5	-1.7	-0.6	0.4
Net Exports Contribution to Growth (%)	-3.2	1.4	1.3	0.0	-0.2	-0.3	-0.4	-0.4	-1.4	-0.9	0.0	-0.4
Inventory Change Contribution to Growth (%)	-0.4	-1.8	-0.5	0.2	0.0	0.0	0.0	0.0	0.4	0.7	-0.2	0.0
Nominal Personal Consumption (YoY % Chg.)	11.1	8.5	7.9	6.6	5.5	4.5	4.2	4.1	12.1	8.5	4.6	3.8
Real Personal Consumption (YoY % Chg.)	4.5	1.9	1.9	1.9	2.0	2.2	2.3	2.2	7.9	2.5	2.2	2.1
Nominal Personal Income	-2.8	4.5	5.0	4.7	4.5	4.2	4.0	4.1	7.5	2.8	4.2	3.5
Retail Sales Ex-Autos	13.6	11.1	10.7	8.4	5.9	3.0	2.4	2.5	19.1	10.9	3.4	2.0
Consumer Price Index	8.0	8.6	8.3	7.0	5.2	3.0	2.3	2.3	4.7	8.0	3.2	2.0
Federal Funds Rate (Upper Bound)	0.50	1.75	3.00	3.50	3.75	3.75	3.75	3.50	0.25	2.19	3.69	2.88
Prime Rate	3.50	4.75	6.00	6.50	6.75	6.75	6.75	6.50	3.25	5.19	6.69	5.88
10-Year Treasury Yield	2.32	2.98	3.08	3.03	3.00	2.98	2.96	2.90	1.45	2.85	2.96	2.80

Forecast as of: September 8, 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.

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Accessibility notes

Figure 1: GDP CAGR ranges from 6.3% in Q1-2021, to a high of 6.9 percent in Q4-2021, a low of -1.6% in Q1-2022, and the latest reading of -0.6% in Q2-2022, with the GDP CAGR forecast to finish 2022 at 2.0%, 2023 at 1.9%, and 2024 at 1.9%. YoY GDP growth ranges from a low of 0.6% in Q1-2021 to a high of 12.2% in Q1-2021, and the latest reading of 1.1% in Q2-2022, with YoY GDP growth forecast to finish 2022 at 1.1%,2023 at 1.1%, and 2024 at 1.2%.

Figure 2: The odds of a recession within 12 months starts at 8.6% in January 2000 and fluctuates over the last two decades with the business cycle. It reaches 99.8% in September 2001, descends to 0.2% by August 2004, and rises to 100% by July 2008 before falling to 2.2% in April 2010. It then fluctuates several times between low single digits and approximately 50% between mid-2010 and mid-2018 before rising to 100% by April 2020. After declining to 0% by April 2021, it rises to 50% in the latest reading for July 2022.