Economic Conditions and Outlook

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The views herein are those of the presenter and do not necessarily reflect those of the Federal Reserve Bank of Kansas City or the Federal Reserve System.
Overview

- Against a backdrop of elevated inflation levels and associated monetary policy responses, we have seen several developments in the regional economy over recent months.

- Household balance sheets began the year at historically strong levels, but more households are reporting difficulty meeting regular expenses.

- Reported growth among regional businesses was at record highs earlier this spring, but forward-looking indicators point to a softening growth outlook.

- Labor markets are historically tight, yet worker quit rates have just begun to decline.
Inflation remains well-above historic norms and the Fed’s 2 percent target.
Households’ ability to pay for usual expenses has deteriorated over the past year

Difficulty Paying for Household Expenses

- U.S.: Week of June 9 - June 21, 2021
- CO: Week of June 1 - June 13, 2022
- NM: Week of June 1 - June 13, 2022
- WY: Week of June 1 - June 13, 2022

Source: U.S. Census Bureau
Increases in commodity prices earlier this year were historically large

* The change in oil prices from February 2022 to March 2022 was the 16th largest on record, and the change in wheat prices in March 2022 was the 7th largest on record, after the Russian Grain Deal and Dust Bowl/WWII period (three months in 1933 were in the top six, and two of those months are excluded for brevity).

Source: The Wall Street Journal, Haver Analytics
Over the past year, the drivers of inflation rotated back toward services, with growth in goods prices softening over the last several months.

![Chart showing contributions to Core CPI Inflation from different categories: Nondurable Goods, Durable Goods, Used Vehicles, Non-Housing Services, and Shelter. The chart includes data from January 2019 to September 2022, with y/y % chg on the y-axis and months on the x-axis. The CPI Inflation is represented by a solid line, while the contributions are shown as colored bars. Source: BLS, Haver Analytics.]
Inflation pressures reflect the imbalances of persistently strong demand relative to ongoing shortfalls in supply.

Sources: Staff, BEA, BLS, CBO, SPF

Note: Annualized PCE Inflation, total and portion attributable to specific factors
Indicators of demand and supply imbalances
Labor market conditions are historically tight

KC Fed Labor Market Conditions Indicators - Level of Activity Index

Sources: KCFRB
Unemployment rates are at or below pre-pandemic lows

Source: BLS, Haver Analytics
Note: Grey bars indicate recession shading
Workers left their jobs at elevated rates over the past 18 months, further tightening the labor market and driving broad-based wage growth.
While labor supply remains constrained nationally

Source: BLS, Haver Analytics
Note: Grey bars indicate recession shading
Employment shortfalls in leisure and hospitality remain acute, adding to cost pressures in that segment of the service sector.
Dismal labor productivity has exacerbated supply constraints, but productivity tends to be subdued during periods of rapid job growth.

Sources: BLS/ Haver Analytics
Monetary policy adjustments transmission to the real economy
The Federal Reserve is moving interest rates further into a restrictive stance of monetary policy to restore price stability.

Sources: Federal Reserve Board, Summary of Economic Projections, Haver Analytics
The Federal Reserve is reducing the size of its balance sheet

Sources: Federal Reserve Board, Haver Analytics
Measures of production across the region point to declining activity, while job growth and labor demand remain healthy.

Sources: KC Fed Manufacturing Survey

Note: An index level above 50 indicates the level of activity is increasing.
The housing market is cooling as the numbers of existing homes sold and the number of new homes constructed are falling.
Worker quits rates and job posting rates are starting to soften, but wage growth remains elevated.

**Job Openings / Unemployed**

- **Ratio:**
  - Jan-20 to Jul-22

**Average Hourly Wage Growth**

- **y/y % chg.:**
  - Jan-20 to Jul-22

Source: BLS, Haver Analytics
The share of employed individuals with more than one job has increased over the past few months.
Global risk factors
High energy costs are generating substantial headwinds for global manufacturing activity
Global growth projections continue to deteriorate

IMF 2023 Global Growth Revisions

<table>
<thead>
<tr>
<th>Region</th>
<th>October 2021 Forecast</th>
<th>April 2022 Forecast</th>
<th>October 2022 Forecast</th>
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<tr>
<td>Euro Area</td>
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<td>Japan</td>
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<tr>
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<tr>
<td>Canada</td>
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<tr>
<td>China</td>
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<td>5.2%</td>
<td>5.1%</td>
</tr>
</tbody>
</table>

Sources: IMF WEO
Global currencies have weakened against the dollar, further tightening financial conditions.
As economic conditions are beginning to change, financial markets are repricing credit risks.

![Graph showing the difference between corporate bond yields and treasury rates over the years 2019 to 2022. The graph includes lines for High Yield, BBB, and AAA ratings, with the Y-axis representing basis points (bps) ranging from 0 to 1200.](image-url)
Prior to tightening of monetary policy, bank had extended the duration of assets on their balance sheets.

**Asset Maturities**
District Banks, Quarterly, Pct of Total

**Unrealized Gains/Losses in AFS Securities**
District Banks, Quarterly

Sources: Source: Reports of Condition and Income
Looking ahead

- Uncertainty about the near- and medium-term outlooks remains elevated

- Wage growth will likely remain elevated even as labor market conditions have become less tight

- Contacts across the region are reporting varied actions to ‘right-size’ their business.
  - businesses in some sectors have started to reduce their employment to align with cooling demand

- The Federal Reserve has stated that a sustained stance of restrictive policy is likely to be appropriate to restore price stability