THE ECONOMIC OUTLOOK GROUP

475 Wall Street
PRINCETON, NEW JERSEY 08540 Tel: 609 - 529 - 1300
www.EconomicOutlookGroup.com

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

May 17, 2022

A Slew of Economic Reports Show Supply of Goods Are Edging Closer to Demand. Will the Fed Take Notice?

It has been the singular question asked repeatedly these days. Is the US economy limping toward a recession? After all, we've already had negative GDP growth in the first quarter. A repeat of that in the second quarter would, at least statistically, constitute a recession.

But as we just saw from the April's retail sales, as well as from numerous other economic reports released today, the very notion the economy is weakening and on track to suffer a recession highlights a gross misunderstanding of what is really going on.

So let's get this right. The decline in 1Q GDP simply reflects how much stronger the US economy is relative to those of other large nations. Hard stop! And April's robust 0.9% jump in retail sales only reinforces that trend. The headline jump in sales even exceeded inflation! If you remove how much Americans spent on gasoline last month, then sales actually increased by 1.3%. Auto sales, which are among the most costly purchases consumers make, rose a solid 2.2%.

Thus, while consumer sentiment surveys tell us Americans are in a dour mood, we see once again that what households actually do tell us more than the "mushy" issue of how they feel.

Gasoline prices at the pump slipped in April, which explains in part the 2.7% drop in outlays at the pump. That decline in prices has turned out to be a brief respite, since the average retail price of gasoline rebounded to highs this month. We should therefore expect to see retail sales (ex-gas) weaken in May. But we don't expect to see a steep fall off for several reasons.

1. Americans apparently are still content to purchase big-ticket items, like cars, electronics and appliances. History has shown that outlays for pricey durable goods

are typically the first to turn down if Americans are genuinely worried about their future finances.

2. The 0.2% decline in shopping for food and beverage suggests that consumers are making adjustments in their shopping habits. They are finding less costly alternatives like, private label groceries or store name brands, which tend to be cheaper than the more familiar retail brands.

3. The strong job market continues to support higher wage growth and thus permit more spending.

4. Americans have accumulated ample savings the last two years and are tapping those funds to maintain their standard of living.

Having said all that, we know Americans also face some harsh headwinds.

Consumer price inflation remains above 8% and the Federal Reserve has raised interest rates more aggressively to dampen consumer and business demand. Jerome Powell hinted the Fed would hit the brakes even harder if that is what it takes to finally lasso in inflation.

But we have already seen tangible signs inflation pressures are beginning to cool. April's CPI (8.3%) pulled back from March's rate (8.5%). Granted, that fractional drop may not be enough to uncork any champagne bottles, but it does suggest we are at or near an inflection point.

Another encouraging sign that prices may be easing can be found in the Fed's latest release on industrial production. This is where we get fresh insights on how much progress industries are making in terms of pumping out supplies.

US manufacturing activity jumped in April for the third consecutive month. Factory output rose 0.8% last month, far better than what was expected. Manufacturers are now operating at their highest capacity in 15 years! The output of consumer goods alone has now risen for four straight months.

Total industrial production, which includes manufacturing, mining and utilities, increased 1.1%, the biggest one month jump in 6 months!

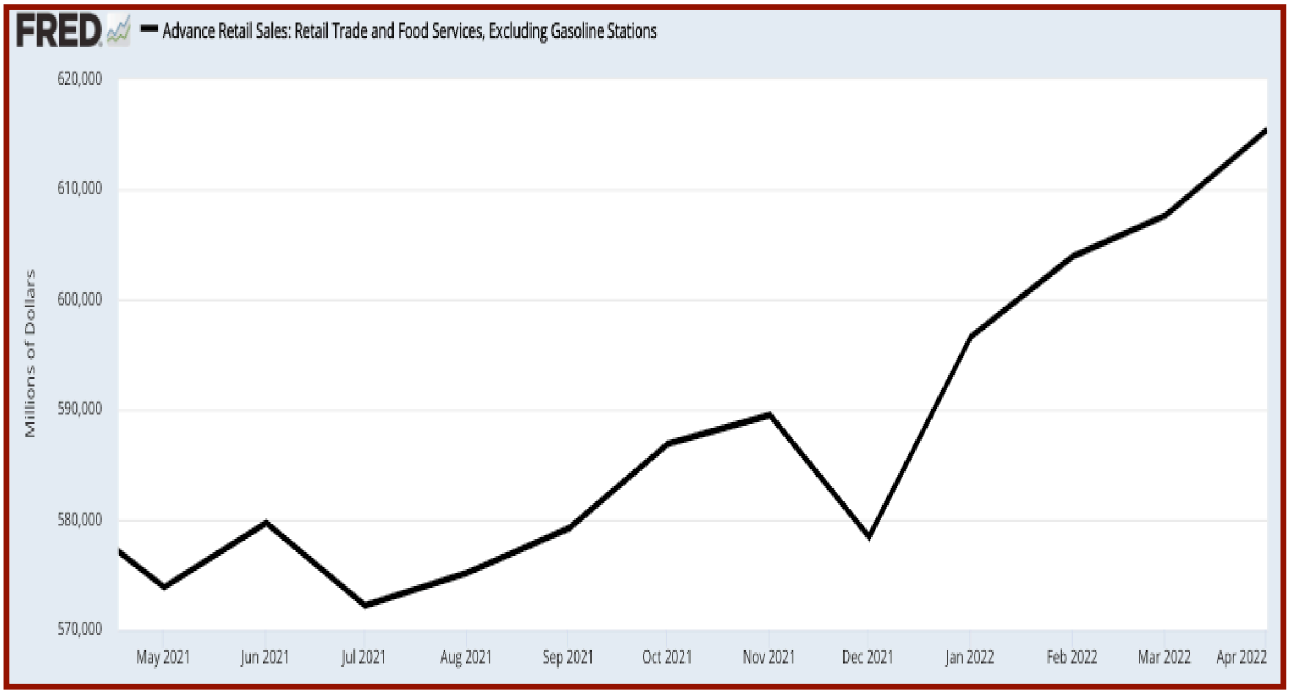
What this tells us is that factories are making the adjustments needed to offset labor shortages. Moreover, the constraints posed by a lack of inventory, from raw material to electronic components, are starting to fade. As more goods get produced and make their way to wholesalers and retailers, worries of scarcities diminish and that helps reduce inflation pressures.

Yet another economic indicator out today, the broadest yet in terms of the flow of goods through the economy, was manufacturing and trade inventories for March and it perfectly corroborated the trend that supply chain bottlenecks are easing.

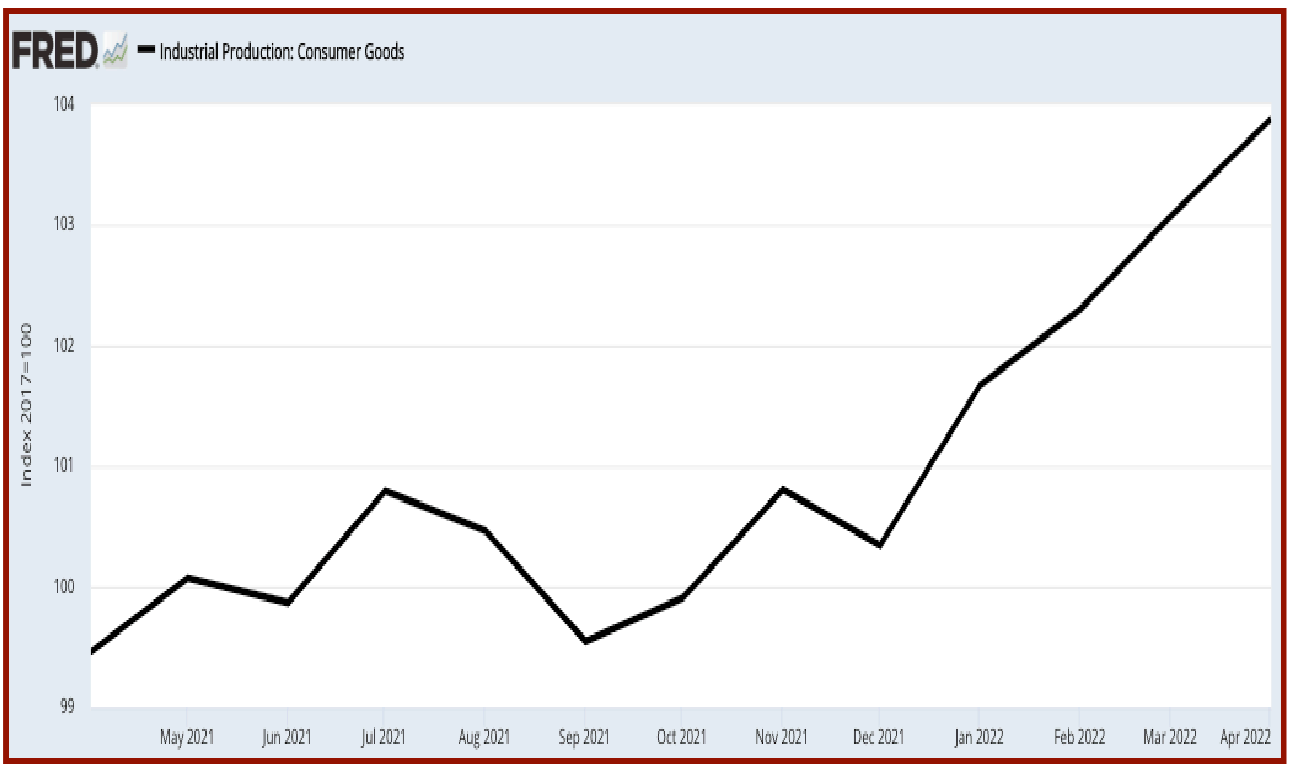
Manufacturing inventories increased 1.3% that month, and is up 10.6% from the year ago level.
Wholesale inventories rose 2.3% in March, and stands 22% year over year.
Retailers are also replenishing their stockrooms, with inventory levels up another 2.3% that month and now stands 11.4% above March 2021's level.

Remember, the key goal here is to get supply edging up closer to overall demand. If that trend continues, we should see inflation continue to retreat in the coming months. With supply and demand moving closer toward equilibrium, there is less of a need for the Fed to place rising interest rates on autopilot.

Demand for retail sales (excluding gasoline)



US factory output of consumer goods



Inventory level of goods at US retailers