Fourth Quarter 2022 Outlook and Review

The U.S. economy grew 2.1% in 2022 according to revised estimates by the Bureau of Economic Analysis. The fourth quarter 2.7% growth rate followed rates of 3.2%, -0.58%, and -1.63% in the prior quarters. The largest contributor to fourth quarter growth was inventory investment. Final Sales of Domestic Product, which adjusts for inventory investment, grew only 1.2% in the fourth quarter. Fixed investment, which is the most interest sensitive component of GDP, declined for the third quarter in a row. The economy is providing uneven signals early in 2023. Leading indicators are in a recession pattern but sentiment indicators and the ISM manufacturing index are not moving in unison. The labor market and overall economic performance continues to be too strong to lower inflation significantly. It now appears as if the Fed must deal with both inflation and the consequences that higher rates have on bank balance sheets. Even though defaults at Silicon Valley Bank and Signature Bank were due to poor management, it is not yet clear if there will be a game-changing contagion effect in the financial system.

The labor market remains very strong. Payrolls gained an average of 315,000 jobs per month in the fourth quarter, which will keep the Fed on a path of raising rates. The unemployment rate edged up slightly from a thirty year low of 3.4% to 3.6% in February of 2023. Wage growth in the fourth quarter was just over 4%, exceeding the 3.5% benchmark that would be more in line with an inflation rate target of 2%. Sluggish productivity combined with wage growth pushed unit labor costs up 6.5% for the year. Lower unit labor costs are necessary to make significant reductions in the inflation rate.

The Fed increased the Fed fund rate by 425 points over the past year and will likely continue raising rates to at least 5% by the end of the year. Even so, the economy is still a long way from achieving an inflation target of 2%. On a year-ago basis the PCE inflation rate was 5.3% in January following a 5.4% rate in December of 2022. The Consumer Price Index (CPI) increased 6.3% and 6.4% over the same period. Consumer spending is slowing as savings accumulated during the COVID shutdown are dwindling and wealth is falling due to stock market losses. The housing market continues to decline as borrowing costs are rising while housing prices remain relatively high. Households are increasing the use of debt to keep up with higher prices and higher rents. Existing fixed income assets are losing value as market rates rise, which is especially damaging to balance sheets of financial institutions holding fixed rate mortgages and long term bonds.

Looking forward, there are still concerns for a recession later in 2023. Risk factors are all on the down side. Both the IMF and World Bank recently lowered global growth estimates. Central banks are on a unified path of raising interest rates but government deficit spending continues to work in the other direction. The U.S. economy is highly levered at all levels with rising consumer debt now taking on a key role. The combination of higher prices of goods and services along with higher interest rate charges for debt have pushed outstanding balances near record highs. When the labor market cools there will likely to be significant increases in debt defaults. The Fed is walking a tightrope between too much or too little contraction to achieve a balance between full employment and low inflation. A soft landing for the economy will be difficult.

The Fed's Long and Winding Road

Fed President Powell recently signaled that more pain is to come from Fed contractionary policies due to the persistence of inflation, strength of the labor market, and strong household spending. The Fed was late to the game when inflation first emerged, thinking that inflation pressures were transitory. Since June 2022 when inflation peaked at 9%, the Fed has been trying to catch up to inflation pressures. The Fed has been able to carve 2.7% from the inflation rate so far, but it hasn't been pretty. The Federal Fund rate is now 450 basis points higher than last year. Another 25 basis points of increases are likely in each of the March and May meetings. Table 1 summarizes the progression of Fed fund rates over the past year. The rapid rise in rates is unprecedented and the full response of the economy to the adjustment takes time. At some point the Fed will pause to fully assess the impact of past rate hikes before contraction goes too far.

Table 1. Monthly Fed Fund and Discount Rates

	Feb 2023	Dec 2022	Sep 2022	Aug 2022	Jun 2022	May 2022	Mar 2022
Fed Fund Rate (Annual %)	4.63	4.38	3.13	na	1.63	0.88	0.38
Discount Rate (Annual %)	4.75	4.50	3.25	na	1.75	1.00	0.50

Source: Board of Governors of the Federal Reserve System, fred.stlouisfed.org

How Fed Contraction Works

The Fed fund rate is the rate banks with excess reserves charge other banks to borrow short term reserves. The Fed fund rate is the base for all other rates and is the key indicator of the level of reserves in the banking system. To achieve a higher Fed fund rate, the Fed sells securities in the open market from its balance sheet. In the fractional reserve requirement system, a bank only has a small fraction of deposits on reserve and the excess is invested in interest sensitive mortgages or interest paying securities. For example, if the reserve requirement is 5% a bank has only 5 cents of reserves backing a $1 deposit. For every $1 loss of deposits due to a Fed security sale the bank must now sell off 95 cents of bonds or mortgages to return to a required reserve level. This process continues because the 95 cents of assets sold in the market reduces deposits at another bank. Ultimately, without leaks or excess reserve holdings, every $1 in Fed security sales leads to a reduction in $20 of deposits. Table 2 shows monthly changes in the Fed's balance sheet that precipitated higher Fed fund rates.

Table 2. Assets Held Outright on Federal Reserve Balance Sheet (Trillions of Dollars)

	Jan 2023	Dec 2022	Sep 2022	Aug 2022	Jun 2022	May 2022	Mar 2022
Total Assets Held Outright	8.38	8.55	8.80	8.83	8.91	8.91	8.94
Treasuries	5.36	5.50	5.67	5.69	5.76	5.77	5.76
Mortgage-backed Securities	2.62	2.64	2.70	2.71	2.71	2.71	2.72
Other	0.40	0.41	0.43	0.42	0.44	0.44	0.46

Source: Board of Governors of the Federal Reserve System, fred.stlouisfed.org

When depositors lose confidence in a bank and draw down deposits, the contraction process works in a similar way. Ultimately the bank must sell earning assets (often long term treasuries or long term mortgages) to get back to a required reserve position. The market value of interest sensitive assets is well below book value due to higher interest rates, tilting the bank balance sheet toward bankruptcy. Competent risk managers at financial institutions do adequate "stress testing" under different interest rate scenarios to determine the institution's vulnerability to rising rates before it happens. A variety of risk management techniques, such as increasing excess reserves or balance sheet hedging of durations are available to manage interest rate risks.

Bank Risk Mismanagement and Moral Hazard?

There has been a full year window for institutions to prepare for rising interest rates. Three factors have complicated bank risk management. First, credit spreads between long term investments and short term deposit liabilities collapsed. An inverted yield curve destroyed the traditional source of profit from owning long term interest earning assets and borrowing short term funds. Second, a grab for higher yields when the yield curve was upward sloping left institutions with long duration assets that could not be unwound easily when market rates rise. Finally, the concentration of very large deposits in single financial institutions created vulnerability to withdrawals that exhaust reserves. For example, 90% of Signature bank's deposits exceeded the $250,000 limit for FDIC insurance. The Biden administration's decision to make good on deposits over the insured limit creates a moral hazard that will allow banks and depositors to continue the risky practice of highly concentrated deposits.

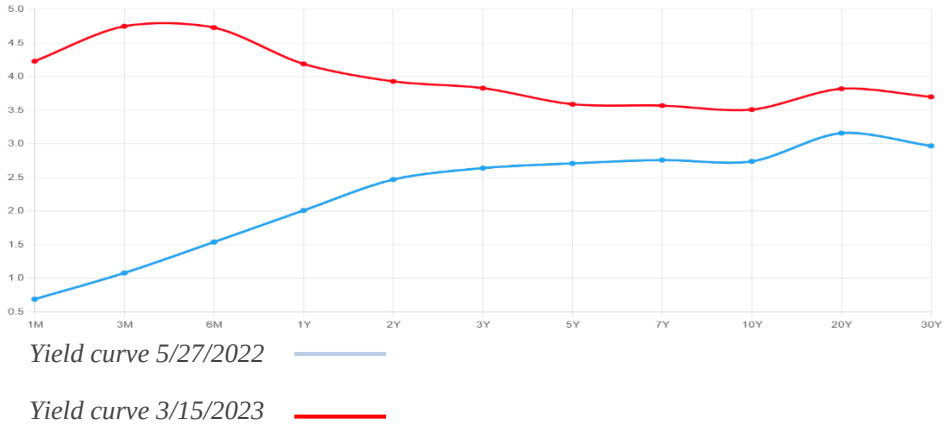
Longer Term Consequences if High Interest Rates Persist

The Fed is trying to engineer a soft landing that will eventually return the economy to pre-2020 levels but with more normal interest rates. Current policies will have longer term effects, especially if interest rates remain high for a long time. After a decade of unprecedented low interest rates businesses loaded up on longer term debt prior to the COVID shutdown. This structure is now unwinding. Approximately $3.1 trillion of U. S. corporate debt will mature over the next three years according to a report by *S&P Global Ratings Research*. If interest rates remain high for an extended period of time firm costs of capital will skyrocket making both profits and long term fixed investment lower. Corporate finance decisions on how and when to roll over debt will become much more complicated. Stock financing will also be expensive if equity market values remain low due to higher interest rates. A lot is riding on the Fed's ability to bring markets back to more normal conditions in a timely manner.

Figure 1 illustrates the change in the Treasury yield curve between May 27, 2022 and March 15, 2023. The lower yield curve (blue) has a normal upward slope allowing a profit spread to banks borrowing at short term rates and lending at long term rates. The current yield curve (red) is inverted and higher, illustrating the collapse in maturity spreads and overall higher interest rates for borrowers. The inverted yield curve occurs when investors expect lower interest rates in the

future due to either a recession or belief that the Fed will be successful in bringing down inflation and interest rates in the future. The Fed will keep pushing on raising rates. The concern is that the economy breaks before inflation does.

Figure 1. Treasury Yield Curve Comparison 5/27/2022 and 3/15/2023



Summary of Recent Economic Data

GDP *– According to the revised estimate by the Bureau of Economic Analysis, the U.S. economy grew 2.7% in the fourth quarter of 2022 following a 3.2% gain in the third quarter. Unlike the third quarter, fourth quarter growth was broad based. The only drags came from exports and residential investment. Inventory accumulation represented a 1.5% contribution to fourth quarter growth, which normally bleeds from the next quarter's growth. Final sales of domestic product (GDP adjusted for inventories) rose 1.2% compared to 4.5% in the third quarter*

- Consumer spending provided only 0.9% of fourth quarter growth. Spending on services provided all of the gain with spending on goods falling in real terms. The decline in spending on goods came entirely from the decline in durable good purchases.

- Nonresidential fixed investment and inventory provided a boost while residential investment declined.

- Government spending at the federal, state, and local levels boosted GDP growth in the fourth quarter.

- Unlike the third quarter, international trade provided only a modest 0.5% boost to growth.

- Table 3 below provides quarterly GDP growth data along with contributions from the GDP components.

Table 3. Gross Domestic Product and its Components (Annualized Percentage Change)

	Q4 2022	Q3 2022	Q2 2022	Q1 2022	Q4 2021	Q3 2021	Q2 2021	Q1 2021
Real GDP (Annual % Change)	2.68	3.24	- 0.58	- 1.63	6.96	2.65	7.00	6.32
Implicit price deflator	3.93	4.36	9.10	8.35	6.84	6.21	6.35	5.07
Consumption	0.93	1.54	1.38	0.91	2.14	1.98	7.84	6.98
Fixed investment	- 0.81	- 0.62	- 0.92	0.83	0.12	- 0.18	1.05	1.70
Inventories	1.47	- 1.19	- 1.91	0.15	5.01	1.96	- 0.75	- 2.52
Net exports	0.46	2.86	1.16	- 3.13	- 0.16	- 1.08	- 0.60	- 1.02
Government	0.63	0.65	- 0.29	- 0.40	- 0.16	- 0.02	- 0.54	1.18

Source: Bureau of Economic Analysis

- Capacity utilization fell to 78.3% in January of 2023 following a utilization rate of 78.4% in December. The long run average is 79.6%. The utilization rate is the lowest since September of 2021 and is not consistent with current full employment and inflation conditions. The manufacturing utilization rate reached 77.7% in January.

- The Manufacturing Purchase Manager's Index was 47.7% in February, marking the fourth straight month of contraction. The index is at its lowest level since May of 2020.

Personal Income and Saving *- Income, spending, and saving reports for January suggest that the economy is far from entering a recession in the first quarter. Personal income gained 0.6% fueled by rising wages and salaries. January's increase in consumer spending was the highest in nearly two years. A longer term problem is building as household debt balances are reaching all-time highs and savings are dwindling.*

- Table 4 summarizes the monthly percentage changes from the prior month for personal income, disposable income, and personal consumption expenditures.

Table 4. Income and Disposable Income Percent Change from Prior Month

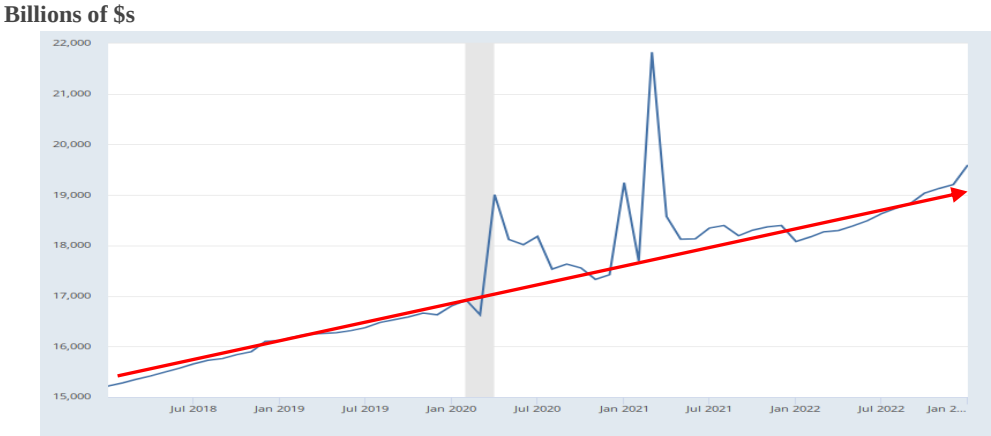
	Sept. 2022	Oct. 2022	Nov. 2022	Dec. 2022	Jan. 2023
Personal Income	0.5	0.9	0.4	0.3	0.6
Disposable Personal Income	0.5	1.1	0.5	0.4	2.0
Personal Consumption Expenditure	0.6	0.7	**-0.2**	**-0.1**	1.8

Bureau of Economic Analysis

- Compensation from private wages and salaries led the increase in personal income for January. An added boost came from the 8.7% increase in Social Security payments from a cost-of-living adjustment.

- Figure 2 illustrates spikes in disposable personal income due to government payments following the COVID shutdown in 2020. Trend lines are shown in red. Attempts by the Fed to cool the economy have not yet had much impact on disposable income.

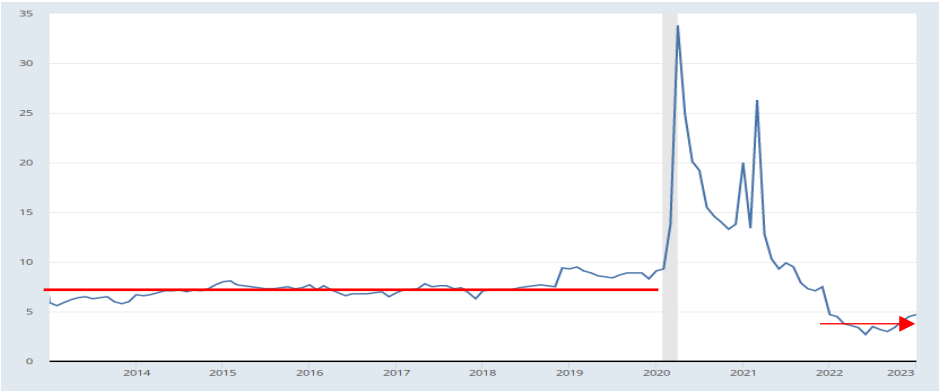
Figure 2. Disposable Personal Income



U.S. Bureau of Economic

- The U.S. personal saving rate for January edged up to 4.7% from 4.5% in December of 2022. Figure 3 below illustrates the spikes in the saving rate linked to COVID relief expenditures and the recent decline to what is now less than the long run average (about 7.5%).

Figure 3. Personal Saving Rate



Source: Bureau of Economic Analysis, Fred.stlouisfed.org

- The Federal Reserve Bank of New York recently released its *Quarterly Report on Household Debt and Credit*. The report included the following data items.

- The Fed reported that household debt increased by $394 billion in the fourth quarter of 2022 to a total of $16.9 trillion. Credit card balances increased by $61 billion to reach a total of $986 billion. Household debt has now surpassed the pre-pandemic highs.

- The Fed also reported that fourth quarter mortgage balances rose to $11.92 trillion, auto loan balances increased to $1.55 trillion, and student loan balances rose to $1.60 trillion. The share of current debt transitioning into delinquency increased for nearly all debt types.

- Balances on home equity lines of credit (HELOC) increased by $14 billion, the third consecutive quarterly increase and the largest increase seen in more than a decade; the outstanding HELOC balance stands at $336 billion.

- Credit card balances increased $61 billion in the fourth quarter of 2022, surpassing the pre-pandemic high of $927 billion. Credit card balances now stand at $986 billion, after declining to $770 billion in 2021Q1. At the end of 2022, 18.3 million borrowers were behind on a credit card,

- Auto loan balances increased by $28 billion in the fourth quarter, continuing the upward trajectory that has been in place since 2011. Other balances such as retail cards and other consumer loans, increased by $16 billion.

- Student loan balances are now $1.60 trillion, $21 billion above the prior quarter.

- Total sales increased 6.1% from November 2022 through January 2023. Sales were 6.1% higher than one year ago. The weakness in sales that typically leads a recession has not yet developed.

Inflation - *All measures of inflation increased in January following moderation in the fourth quarter of 2022. On a year-ago basis, the PCE is 5.4% higher. In January the PCE increased 0.6%, which is in line with increases in the consumer price index (CPI). January's inflation data does not bode well for those hoping the Fed will back off from raising interest rates. The move toward the Fed's 2% inflation target is not going to be a smooth linear path. Another 25 basis point increase in the Fed Fund rate in March is likely and a 50 basis point hike is not out of the question.*

- The PCE price index increased 3.7% in the fourth quarter, down from 4.3% in the third quarter. The Core PCE, excluding food and energy, gained 4.3% compared to a gain of 4.7% in the prior quarter.

- The PCE deflator increased 0.6% in January following a more modest 0.2% gain in the last two months of 2022. The core PCE, excluding food and energy, also gained 0.6% in January following a 0.4% gain in December. On a year-ago basis the PCE gained 5.4% with a 4.7% gain in the core PCE.

- Goods prices for the PCE increased 0.6% after declining during the prior three months. Durable goods prices increased 0.3% after declining 0.2% in December and 0.6% in November. Nondurable goods prices increased 0.8% after falling 0.7% in December.

- Food prices were up 0.4% in December and January. Energy prices were up 2% in January following a 3.6% decline in December.

- Table 5 provides the monthly and year-ago inflation rates for the PCE and Core PCE.

Table 5. Personal Consumption Expenditure Deflator

	Jan 23	Dec 22	Nov 22	Oct 22	Sep 22	Aug 22	Jul 22
Monthly % Change							
PCE	0.6	0.2	0.2	0.4	0.3	0.3	- 0.1
Core PCE	0.6	0.4	0.2	0.3	0.5	0.6	0.1
% Change yr. Ago							
PCE	5.4	5.3	5.6	6.1	6.3	6.3	6.4
Core PCE	4.7	4.6	4.8	5.1	5.2	4.9	4.7

Source: Bureau of Economic Analysis

- The Consumer Price Index (CPI) increased 0.5% in January following gains of 0.1% and 0.2% in December and November, respectively. The CPI for energy increased 2% in January after declining by 3.1% in December. Food prices increased 0.5% in January following a 0.4% gain in the prior month. The Core CPI, excluding food and energy, gained 0.4% in both December and January.

- On a year-ago basis, the CPI increased 6.3% in January. While still high, year-ago CPI inflation is at its lowest since October 2021. The core CPI increased 5.5% on a year-ago basis in January following a 5.7% gain in the prior month. Table 6 provides the monthly and year-ago CPI percentage changes.

Table 6. Consumer Price Index Percentage Changes

	Jan 23	Dec 22	Nov 22	Oct 22	Sep 22	Aug 22	Jul 22
Monthly % Change							
CPI	0.5	0.1	0.2	0.5	0.4	0.2	0.0
Core CPI	0.4	0.4	0.3	0.3	0.6	0.6	0.3
% Change yr. Ago							
CPI	6.3	6.4	7.1	7.8	8.2	8.2	8.4
Core CPI	5.5	5.7	6.0	6.3	6.6	6.3	5.9

Source: Bureau of Labor Statistics

- Table 7 illustrates the difference in the Core PCE and Core CPI. Normally the CPI measure of inflation is higher than the PCE. The margin fell in January of 2023.

Table 7. Difference between Core PCE and Core CPI (% Change)

	Jan 23	Dec 22	Nov 22	Oct 22	Sep 22	Aug 22	Jul 22
Core PCE – Core CPI	- 0.8	- 1.1	- 1.2	- 1.2	- 1.4	- 1.4	- 1.2

- The Producer Price Index (PPI) for final goods jumped by 0.7% in January following a decline of 0.2% in December. On a year-ago basis the annual increase in the PPI was 6%. Overall, producer prices are easing. Table 8 shows the monthly progression of the PPI.

Table 8. Producer Price Index Final Demand

	Jan 23	Dec 22	Nov 22	Oct 22	Sep 22	Aug 22	Jul 22
Monthly % Change							
PPI Final Demand	0.7	-0.2	0.3	0.3	0.3	0.0	-0.3
% Change yr. Ago							
PPI Final Demand	6.0	6.5	7.3	8.2	8.5	8.7	9.7

Source: Bureau of Labor Statistics

Employment and Labor – *The labor market remains too strong to tame inflation. Employers are using elevated pay increases to attract workers while labor productivity remains low. The net effect is higher unit labor costs. Wage growth closer to 3.5% would be consistent with a 2% inflation rate, given the productivity rate.*

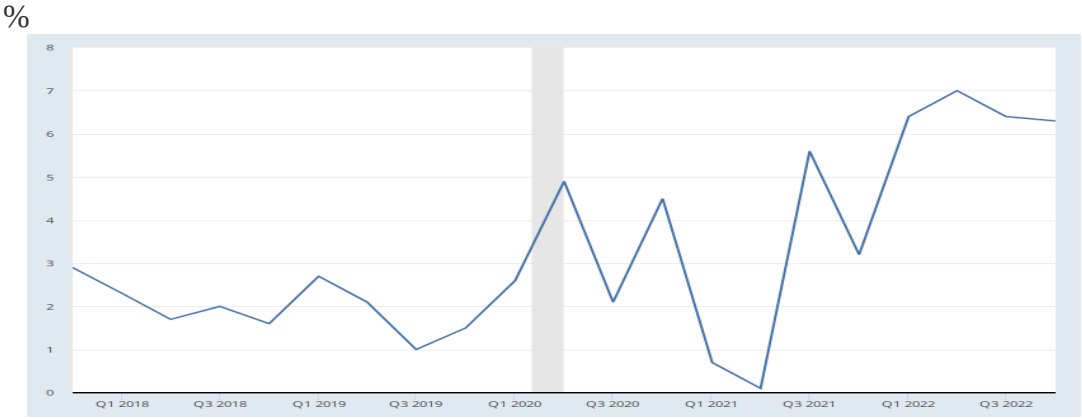
- The unemployment rate edged up to 3.6% in February from a 50-year low of 3.4% in January. The U-6 unemployment rate (including people who want to work, but have given up searching and those working part-time because they cannot find full-time employment) increased to 6.8% in February following a 6.6% rate in January.

- Labor productivity gained a very modest 1.7% in the fourth quarter of 2022. On a year-ago basis labor productivity gained 1.8%. Manufacturing productivity fell 2.7% in the fourth quarter and 1.9% on a year-ago basis.

- Annualized wage growth in the fourth quarter was just over 4%. Over the past year average hourly earnings increased 4.4%. According to *Statista* real average wages increased 2.65% from 2021 to 2022.

- Low labor productivity and higher wages drove unit labor costs higher in the fourth quarter. Unit labor costs increased 3.2% at an annualized rate in the fourth quarter following increases of 6.9%, 6.6% and 8.5% in the prior quarters. For the year, unit labor costs increased 6.5%, adding to inflation pressure.

Figure 4. Nonfarm Business Unit Labor Costs (Annual % Change)



Source: Bureau of Economic Analysis, Fred.stlouisfed.org

- Payrolls gained an average of 351,000 jobs per month over the past three months. The fast growth in jobs runs counter to what the Fed is trying to achieve and increases chances of higher rate hikes going forward.

- The labor force participation rate inched higher to 62.5%, the highest since March 2020. Higher wages generally entice more workers to enter the labor force.

- The number of employed workers increased to 160.32 million in February with 5.94 million unemployed.

- Average hourly earnings gained 0.2% (annual rate of 3.6%) in February from January. Over the past year, hourly earnings increased 4.6%.

- Average weekly hours worked ticked down from 34.6 to 34.5.

- The number of job openings per unemployed worker is falling but continues to be higher than pre-COVID levels.

- Payroll gains continue to be stronger than expected and do not yet suggest that Fed policies are slowing the labor market. January payrolls increased by 517,000, following a revised 260,000 in December. Over the last three months the average gain was 356,000.

- For 2022, average job growth in the first half of the year was 445,000 followed by a slower 357,000 gain in the second half.

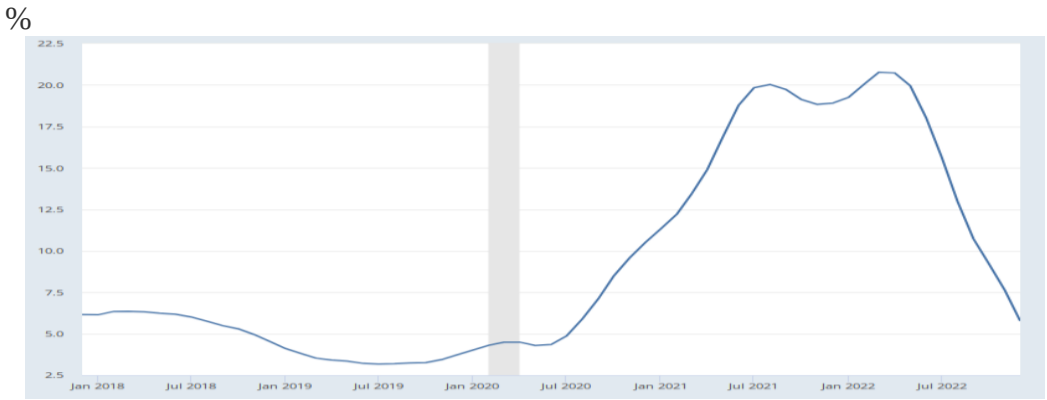
- Initial claims for unemployment insurance remain low with a trend under 200,000 per week.

- The quit rate for January was 2.6%, which is the lowest in two years. The average quit rate for 2019 was 2.3%. A low quit rate suggests workers do not see higher paying jobs elsewhere. A low quit rate with higher layoffs is needed to ease pressure on wages.

***Housing** – The housing market saw a rapid rise in prices during the first half of 2022 before higher mortgage rates cooled housing demand in the second half. Overall, housing prices were up 4.6% on a year ago basis at the end of 2022. Mortgage rates softened from 7% last fall to 6.5% but higher rates are likely going forward as the Fed continues to fight inflation.*

- Housing prices fell by 0.5% in December, marking the sixth straight month of decline, according to the S&P CoreLogic Case-Shiller 20-City Composite Index. For the year, housing prices were up 4.6% due to the strong first half of the year. Figure 5 illustrates the movement of year-ago percentage changes in the Case-Shiller Home Price Index.

Figure 5. Case Shiller U. S. National Home Price Index (Year-ago Percent Change)



Source: S&P Dow Jones Indices LLC, fred.stlouisfed.org

- Mortgage rates peaked at 7% in the fall of 2022 but ended the year at 6.5%. Higher mortgage rates have temporarily left some buyers out of the market but pent up demand should materialize when inflation moves closer to the Fed target.

- Consumer saving rates dropped below the long run average following the post COVID spikes. Less available savings for down payments pushes buyers to either take out larger loans or downsize home size.

- Higher interest rates and inflation are combining to drive housing construction costs higher. Total private residential construction spending has been on a downward slope since May. In the long run, the supply of housing will fall short of demand as inflation eases and the economy gets back on track.

- According to the National Association of Home Builders, in 2022 the median new home price was $454,000 and the median existing home price was $392,800.

Sentiment and Confidence *– The University of Michigan Consumer Sentiment Index and the Conference Board Consumer Confidence Index are providing conflicting signals. The Michigan Index is in recession territory but improving. The Conference Board Index is well above a recession indication. This inconsistency mirrors mixed economic data with a strong job market and 3.6% unemployment while interest rates are high and rising.*

- The University of Michigan consumer sentiment index has improved since a low in June of 2022. The index improved since then but not enough to pull it out of recession territory. The index is below its 2020 trough and the level at the start of 2022.

- Consumer sentiment data from the University of Michigan survey shows some softening in 1-year inflation expectation with 5-year expectations holding relatively steady at 2.9%. These expectations are in line with a slow and steady improvement in inflation. Nevertheless, inflation is expected to remain above the 2% target for a long time.

- Table 10 illustrates the monthly change in the University of Michigan Index.

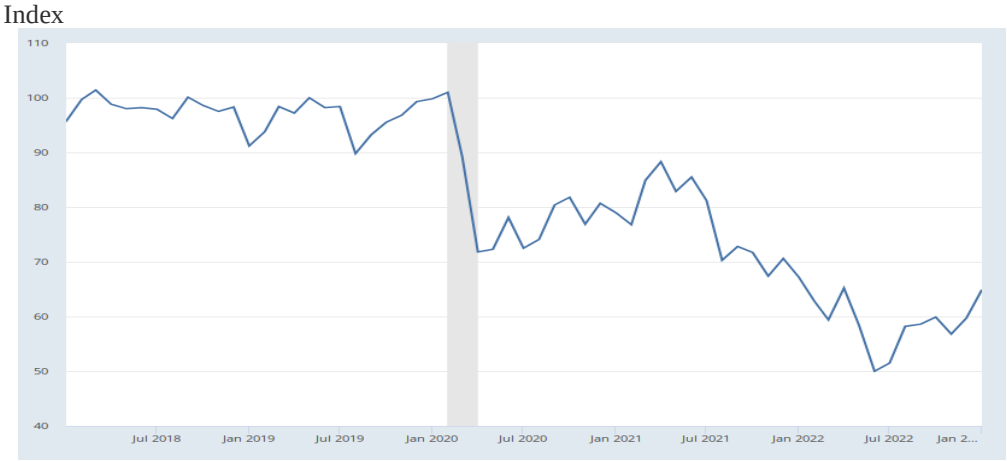
Table 10. University of Michigan Consumer Sentiment Index (Index = 100 in 1966)

	Feb 2023	Jan 2023	Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022
Overall Index	67.0	64.9	59.7	56.8	59.9	58.6	58.2
Change in Index	2.1	5.2	2.9	-3.1	1.3	0.4	6.7
Inflation Expectations 1-Year Forward	4.1	3.9	4.4	4.9	5.0	4.7	4.8
Inflation Expectations 5-Year	2.9	2.9	2.9	3.0	2.9	2.7	2.9

Source: University of Michigan, fred.stlouisfed.org

- Figure 6 below illustrates the monthly movement of the University of Michigan Consumer Sentiment Index to include the slide during COCID and weak showing since then.

Figure 6. University of Michigan Consumer Sentiment Index (Index = 100 in 1966)



Source: fred.stlouisfed.org

- In January, the Conference Board Consumer Confidence Index fell for the second straight month from 106 to 102.9. However, the index is 7.6% higher than the trough last July when inflation pressures were most severe.

- The consumer expectations component of the Conference Board's index fell from 76 to 69.7. A reading of the index below 80 generally signals a recession within the next 12 months. On the other hand, the present situation component of the index improved from 151.1 to 152.8, largely due to the strong labor market.

- Inflation expectations in the Conference Board Index fell slightly from 6.7% to 6.3% in February. Inflation expectations need to come down to prevent a spiraling effect where consumers spend more now in anticipation of higher prices going forward.

- The Index of Leading Economic Indicators fell in February for the 11th straight month. The prolonged decline in the index is consistent with a recessionary signal (see Table 11).

Table 11. Conference Board Leading Indicators Index®

	Jan 2023	Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022
Leading Indicator (%)	-0.3	-0.8	-0.9	-0.9	-0.5	-0.3	-0.6
Leading (% Change, 3-mo. Moving Average	-0.7	-0.9	-0.8	-0.6	-0.5	-0.5	-0.7

Source: Conference Board

U. S. Trade - *The U.S. trade account started the year with an increased trade deficit to the tune of $68.3 billion. The dollar fell relative to trading partners in the last half of 2022 but is rebounding in the early stages of 2023. A strong dollar tends to hamper U.S. exports, increase imports, and attract foreign capital.*

- The U.S. trade deficit increased by $1.1 billion in January reaching a level of $68.3 billion. The goods deficit fell by $600 million, but the surplus in services trade also declined, by $1.7 billion. The higher trade deficit represents a drag on 2023 GDP. See Table 12 for a monthly summary of U. S. exports and imports.

- While the price of U.S. exports increased in January, the costs of imports remained the same. When adjusted for price changes, real exports increased only 3.8% in January rather than the 5% nominal increase.

Table 12. U. S. Trade Account by Month (Billions of Dollars)

	Jan 23	Dec 22	Nov 22	Oct 22	Sep 22	Aug 22	Jul 22	Jun 22
Trade balance	-68.3	-67.2	-60.6	-77.2	-72.6	-64.6	-69.8	-80.8
Exports	257.5	249.0	252.0	256.7	259.1	262.3	261.3	259.6
Imports	325.8	316.2	312.7	333.8	331.8	326.9	331.0	340.4

Sources: U.S. Census Bureau; U.S. Bureau of Economic Analysis

- The U. S. Dollar fell relative to the Euro during the COVID shutdown and reversed trend to strengthen until mid-2022. Recently the dollar has weakened again. The dollar strengthens when the U.S. real rate of return is higher than the trading partners.

- As the dollar falls the advantage in the balance of trade for the U.S. improves, everything else equal. On the other hand, a weaker dollar makes it cheaper for foreign borrowers to repay dollar denominated loans.

- Figure 7 illustrates the dollar per euro exchange rate movement over the past five years.

Figure 7. U.S. Dollar to Euro Spot Rate (Dollars per Euro)

Source: Board of Governors of the Federal Reserve System, fred.stlouisfed.org

World Bank Global Economic Report (January, 2023)

- The World Bank lowered its forecast for global growth from 3% to only 1.7% for 2023. The 2023 projected growth would be the third lowest rate in nearly thirty years. The World Bank estimated 2022 growth to be 2.9%. The key factors behind the downward revision were global policy tightening, continued high inflation, weaker financial conditions, and continued global disruptions from the invasion of Ukraine.

- The World Bank report addressed issues in the United States, the euro area, and China. These economies are dealing with a combination of slow growth, tightening financial conditions, and heavy indebtedness. These conditions will likely weaken investment, push solvency of financial institutions to the limits, and trigger corporate defaults. Any additional shocks would push the forecast lower into a global recession scenario.

International Monetary Fund (IMF) World Economic Outlook (January, 2023)

- The IMF *World Economic Outlook* is much more optimistic about global growth. The forecast for 2023 growth was lowered to an estimated 2.9% rate from the previous 3.4% rate. By comparison, the historical growth rate from 2000 to 2019 was 3.8%.

- The IMF forecasts that global inflation will fall from 8.8% in 2022 to 6.6% in 2023 followed by 4.3% in 2024. The IMF noted that the balance of risk is on the downside.

- Table 13 summarizes the 2023 and 2024 IMF real growth projections for selected countries.

Table 13. IMF Estimates and Projections for Real GDP Growth Rates

	2022 Estimate	Projected 2023	Projected 2024
World	3.4	2.9	3.1
Advanced Economies	2.7	1.2	1.4
U.S.	2.0	1.4	1.0
Euro	3.5	0.7	1.6
Germany	1.9	0.1	1.4
France	2.6	0.7	1.6
Italy	3.9	0.6	0.9
Spain	5.2	1.1	2.4
Japan	1.4	1.8	0.9
U.K.	4.1	-0.6	0.9
Canada	3.5	1.5	1.5
Other Advanced	2.8	2.0	2.4
Selected Economies			
China	3.0	5.2	4.5
India	6.8	6.1	6.8
Russia	-2.2	0.3	2.1

Source: https://www.imf.org/en/Publications/WEO/Issues/2023/01/31/world-economic-outlook-update-january-2023