UNITED STATES: A RECESSION LIES AHEAD

US growth recovered significantly during Q3, but is expected to slow down during Q4 according to our forecasts. The labour market is still tight, but early signs of a slowdown are emerging. Headline inflation appears to have peaked, but core disinflation remains to be confirmed, which would forced the Federal Reserve (Fed) to continue its monetary policy tightening, even if it means pushing the economy into a recession in 2023. Looking at the budget, compromise will be key when the next deadlines approache, given the divided Congress following the mid-term elections.

US GDP growth rebounded strongly during Q3 (+2.9% quarterly annualized rate of growth, after revision), following two quarters of negative growth (-1.6% during Q1 and -0.6% during Q2). The upturn in growth was driven by the very positive contribution of net exports, which was based on a big increase in exports of goods and services (+15.3%) and a large fall in imports (-7.3%). Despite the inflation shock, personal consumption expenditures held up well (+1.7%) and contributed positively to growth, as did non-residential fixed investment, which rebounded in Q3 (+5.1%), following a slump in Q2. By contrast, residential investment continued to fall, dropping for the sixth consecutive quarter (-26.8%). Despite showing signs of resilience, the US economy is expected to slow down, before going into a rather mild recession in 2023, due to the sizeable inflation shock and the Federal Reserve (Fed) monetary tightening. We expect inflation persistence to convince the US central bank to keep its policy rates at restrictive levels until at least 2024.

AN UPCOMING SLOWDOWN IN SPENDING

For the time being, consumer spending is still high, given the inflation shock and the rise in borrowing costs. Retail sales rebounded strongly in October (+1.3% m/m). This momentum can be seen in both vehicle sales (+1.3%), thanks to disruptions along supply chains abating, and gasoline sales (+4.1%), but also in Retail sales excluding gas and autos which rose +0.9%. However, the inflation shock could well end up impacting more negatively consumer spending. According to the Conference Board and University of Michigan indices, consumer confidence fell further in November (-2 points and -3.1 points respectively), mainly due to a deterioration in their financial situation. In addition, the gap between consumer confidence about the current situation and the situation in 6 months' time (Conference Board), and the situation in 12 months' time (University of Michigan) is narrowing, which indicates that customers are less confident about the future (see chart 1). In the past, such a deterioration was a leading signal of recession.

THE END OF "GREAT RESIGNATION"?

For the time being, the good performance of the labour market continues to bolster purchasing power. Even though the unemployment rate remained stable in November (3.7%) after rising in October (+0.2 points), nonfarm payrolls gains remained significant (+263k m/m), albeit at a slower rate than in October (284k, following revision). Labour shortages, i.e. an insufficient number of workers available to meet the demand, remain at high levels.

One way to measure labour shortages is to look into the relationship between the number of jobseekers (U) and the level of job vacancies (V). In October, there were almost two vacancies for every person looking for a job, suggesting that labour shortages are very severe (see chart 2).

GROWTH & INFLATION

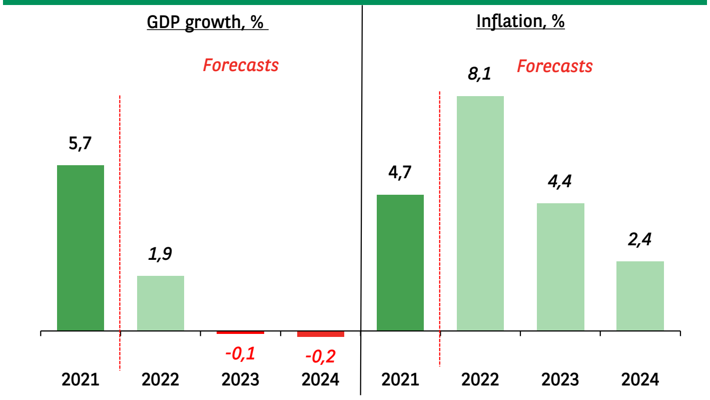

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

HOUSEHOLD CONFIDENCE

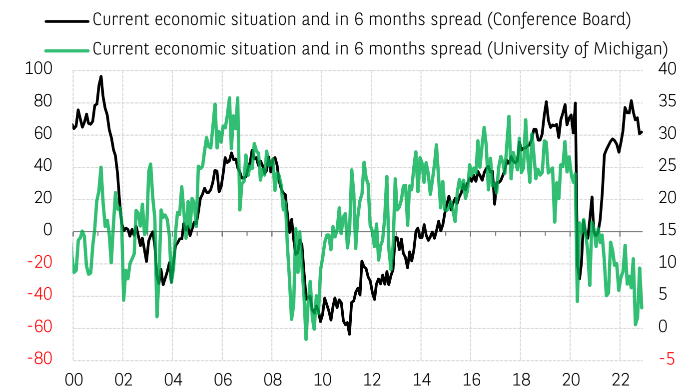

CHART 2 SOURCE: CONFERENCE BOARD, UNIVERSITY OF MICHIGAN, BNP PARIBAS

There are several potential factors behind this tight labour market. The labour shortage is partly due to less efficient matching, mainly due to the lack of qualifications and training within the labour force, but also due to a fall in the participation rate, driven in particular by large numbers of early retirements. Another potential explanation emerges by breaking down job postings into two categories: one type of posting targeted at unemployed workers and the other one applied to poach workers (from existing positions at other firms). A recent article by the Federal Reserve Bank of Dallas[1] illustrated that the number of job postings for poach workers is much higher than the number of jobs available for unemployed people, which, in particular, highlights how many people are moving from one job to another («The Great Resignation»). According to this analysis, the fall in the number of job postings, as a result of the upcoming slowdown in economic activity, could result in a minor rise in the unemployment rate, as it would hit job postings designed to poach workers harder.

These tight labour-market conditions contribute to the dynamism of wages, which is bolstering purchasing power to some extent against the rising cost of living. Annual growth in average hourly earnings (AHE) hit 4.9% (y/y) in October, but remained largely negative in real terms (-2.8% y/y), i.e. adjusted for inflation. Early signs of a deceleration in wages are appearing however. According to the Atlanta Federal Reserve's Wage Growth Tracker[2], the median percent change in the hourly wage of individuals peaked between July and August (+6.7% y/y), before somewhat slowing to +6.4% (y/y) in October and November. This slowdown in wage growth was particularly pronounced for job switchers between July (+8.5%) and October (7.6%), before rebounding in November (+8.1%) . The trend is still unclear for job stayers (+5.5% in November, compared with +6.1% in June). If this trend of a slowdown in wage growth is confirmed, which is highly likely, employees may be less inclined to change jobs for salary reasons, which could alleviate the tightness of the labour market.

The easing of tightness on the labour market is also expected to support the ongoing disinflation. Since peaking in June (9% y/y), the consumer price index (CPI) continued to slow down to 7.8% (y/y) in October. This downtrend is lessclear-cut for the core component (6.3% y/y), particularly in view of the continued rise in inflation in non-energy services since July 2021, which hit 6.8% (y/y) in October.

Faced with persistent inflation and a still tight labour market, the Fed is expected to continue tightening its policy rates and reducing its balance sheet. However, the pace of interest rate hikes could well slow down, from the December meeting, according to Fed Chairman Jerome Powell. On the one hand, the Federal Open Market Committee (FOMC) does not want to overtight, which would push the economy into a recession. On the other hand, he also does not want to slow down prematurely the tightening of its monetary policy, as this could lead to inflation spiralling out of control again. After all, disinflation is still limited to goods and real estate prices, while inflation continues to spread in services, driven by an overly tight labour market (see chart 3).

A DIVIDED CONGRESS

The mid-term elections brought contrasting fortunes for the two main political parties, as the Republicans won a majority in the House of Representatives, while the Democrats held on to the Senate.

This divided Congress will force the US government to look for compromises around the budget. In the short term, the government must deal with the expiry of the continuing resolution on 16 December, which, without an annual budget for the 2023 fiscal year, would lead to a government shutdown. In the medium term, as the debt ceiling will be hit during 2023, despite buoyant fiscal revenues, it will need to be lifted. If a deal, possibly last-minute, between Democrats and Republicans is the most likely scenario, the debate is likely to be a fierce one.

UNFILLED JOB VACANCY PER UNEMPLOYED PERSON

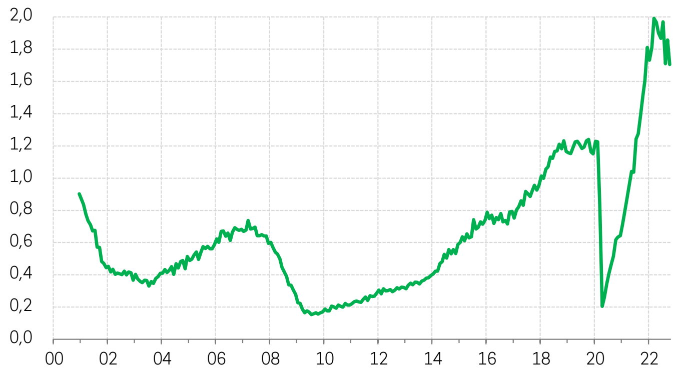

CHART 3 SOURCE: BLS, BNP PARIBAS

COMMODITIES AND SERVICES INFLATION

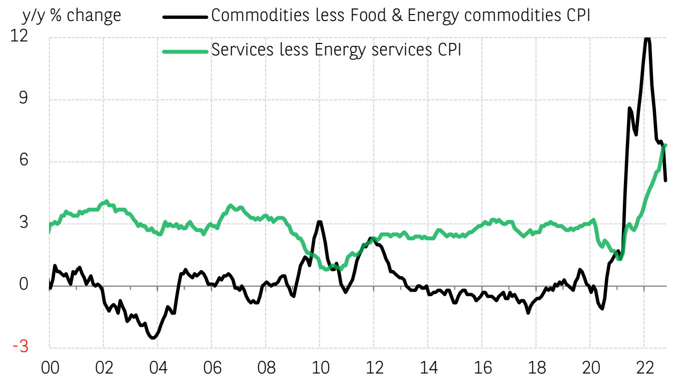

CHART 4 SOURCE: BLS, BNP PARIBAS

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1 Anton Cheremukhin, *«Does Employers' Worker Poaching Explain the Beveridge Curve's Odd Behavior?», Dallas Fed Economics, November 2022.*

2 Félix Berte, *«The end of wage bargaining power», Charts of the week, BNP Paribas, November 2022.*