Visa Business and Economic Insights

U.S. Economic Outlook

The inflation inflection point?

May 12, 2022

Wayne Best
Chief Economist
wbest@visa.com

Michael Brown
Principal U.S. Economist
michael.brown@visa.com

Key Points:

- GDP expected to bounce back in Q2
- The rate hikes just keep coming
- Geopolitical and inflation risks remain

Economic conditions over the last month have developed in line with our expectations. A downshift in inventory building combined with a surge in imports subtracted from gross domestic product (GDP) growth, leading headline real GDP growth to contract 1.4 percent (annualized) in Q1. More importantly, core economic growth (how consumers, businesses and governments are spending and investing) rose from 1.7 percent in Q4 to 2.6 percent in Q1.

Early indicators of Q2 GDP growth suggest continued economic growth ahead, albeit at a more modest pace. Employment growth remains solid, with 428,000 jobs added in April, but average hourly earnings edged down slightly, to 5.5 percent year-over-year (YoY) growth. Gauges of the manufacturing and service sectors edged lower but continued to signal growth, just at a slower pace. Following the negative GDP print in Q1, we expect Q2 real GDP growth to rise 0.5 percent and quarterly GDP growth to remain positive through our current forecast horizon of 2023. The downshift in economic activity relative to last year may feel like the economy is slipping, but at this point we see little evidence to suggest a recession is in the cards.

There are risks, however, primarily tied to the outlook for inflation. We have been at the lower end of the consensus views on GDP growth for this year and next, mainly due to our view that inflation will be more persistent. Incoming data suggest monthly gains in inflation may be starting to level off. As we lap the high inflation readings of last year and reach greater price stability for gasoline and other goods, the YoY rate of inflation should come back down. The Federal Reserve is expected to assist in this trend, with aggressive interest rate hikes to cool excess demand in the economy.

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

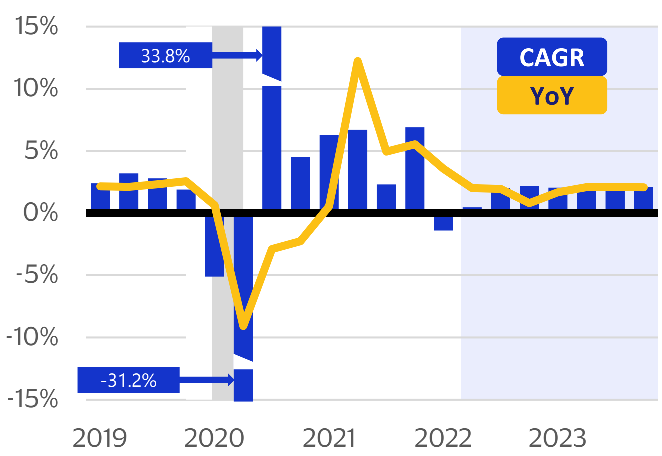
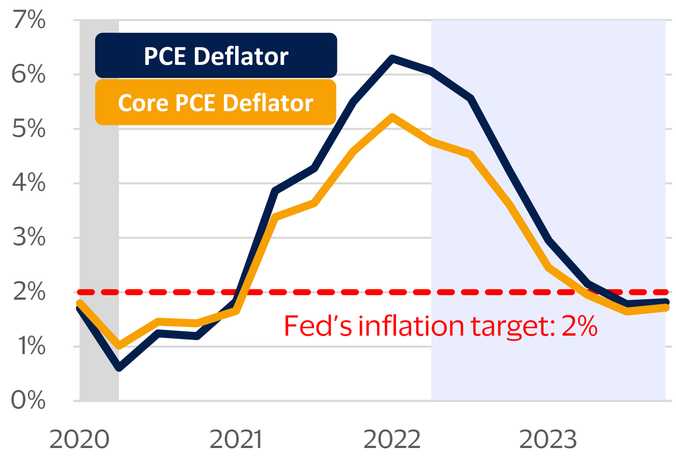


Fig. 2 PCE and core PCE deflator forecast
(SA, YoY percent change)



*Seasonally adjusted (SA), compound annualized growth rate (CAGR), year-over-year (YoY). **Visa Business and Economic Insights
Sources: Visa Business and Economic Insights, U.S. Department of Commerce and U.S. Department of Labor.

The inflation inflection point?

Consumer spending set to downshift

Consumer spending is set to downshift in the second half of this year in our view. High consumer prices and much higher borrowing costs are still the key drivers as the Fed hikes rates. Our April Spending Momentum Index, which gives insight into the inclusiveness of consumer spending, fell for the second straight month, suggesting that consumer spending growth is more concentrated among a smaller group of consumers. While aggregate wage growth is still expanding 5.5 percent above last year's levels, inflation rates are rising much faster, eroding consumers' real purchasing power.

There are signs, however, that inflation rates may top out in Q2. For starters, the average price of used cars has started to come down and, beginning in Q3,the price of oil will lap the increases of last year. Additionally, while average hourly earnings trended higher in April, the YoY pace of growth slowed. Should this trend continue, persistent inflation pressures might begin to ease, which would be welcome news for consumers.

Receding inflation pressures account for part of our downward revision to nominal consumer spending this month. We now expect nominal spending to rise 8.7 percent (YoY) this year, with real spending rising 3 percent. Looking ahead to next year, inflation will likely still prop up nominal spending at 2.2 percent. With the headwinds of inflation and higher interest rates, real spending growth in 2023 is expected to rise 2.3 percent, closer to the 1.7 percent growth in real disposable income.

Rates just keep grinding higher

Our update this month includes a refreshed view of interest rates. Long-term rates such as the U.S. 10-year Treasury have pushed significantly higher since our last update. We now expect the 10-year rate to be 3.06 at the end of Q2, which in our view would be the high point for the year. We suspect that with greater capital inflows into the U.S., the dollar will continue to strengthen and long-term interest rates will start to come down as foreign buyers of Treasuries step in. Lower Treasury supply from a smaller budget deficit will also help to drive the price of the 10-year Treasury up and the yield (rate) down. Another change in this month's outlook is that we now see another 50-basis point hike from the Fed in July as likely. Thus, we now think the federal funds rate will reach 2.50 percent by the end of this year. The funds rate is expected to top out this cycle at 3.25 percent by the third quarter of next year. By that time, we expect the Fed to stop hiking rates, as inflation will have moderated and GDP growth downshifted to its longer-run average.

Risks to the outlook

Risks to our outlook this month are roughly unchanged. Geopolitical and inflation risks are still the key factors most likely to weigh on GDP growth. Another emerging concern is the possibility for consumer confidence to slide due to recent stock market sell-offs, which could slow consumer spending. On the upside, should inflation pressures recede faster than expected, then we could see more robust real GDP growth in the second half of this year.

	Actual				Forecast				Actual		Forecast	
	2021				2022							
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2020	2021	2022	2023
Gross Domestic Product (CAGR)	6.3	6.7	2.3	6.9	-1.4	0.5	2.0	2.2	-3.4	5.7	2.1	2.0
Personal Consumption	11.4	12.0	2.0	2.5	2.7	2.6	2.3	2.3	-3.8	7.9	3.0	2.3
Business Fixed Investment	12.9	9.2	1.7	2.9	9.2	10.2	6.3	5.6	-5.3	7.4	6.6	5.6
Equipment	14.1	12.1	-2.3	2.8	15.3	7.4	6.3	5.3	-8.3	13.1	7.2	5.0
Intellectual Property Products	15.6	12.5	9.1	8.9	8.1	8.4	7.7	7.4	2.8	10.0	8.6	7.5
Structures	5.4	-3.0	-4.1	-8.3	-0.9	2.0	2.2	1.8	-12.5	-8.0	-1.8	1.4
Residential Construction	13.3	-11.7	-7.7	2.2	2.1	-1.9	-0.4	-0.2	6.8	9.2	-1.3	-0.1
Government Purchases	4.2	-2.0	0.9	-2.6	-2.7	0.2	0.4	0.8	2.5	0.5	-1.1	0.8
Net Exports Contribution to Growth (%)	-1.6	-0.2	-1.3	-0.2	-3.2	0.4	-0.1	-0.4	-0.3	-1.4	-1.3	-0.3
Inventory Change Contribution to Growth (%)	-2.6	-1.3	2.2	5.3	-0.8	-0.8	-0.5	-0.1	-0.5	0.4	0.8	-0.2
Nominal Personal Consumption (YoY % Chg.)	3.9	20.7	11.7	12.8	11.3	8.7	8.3	6.8	-2.6	12.1	8.7	4.5
Nominal Personal Income	16.1	1.6	5.3	7.2	-3.0	3.6	3.5	3.5	6.5	7.4	1.9	3.9
Retail Sales Ex-Autos	12.6	29.7	16.3	18.9	13.4	8.9	7.2	5.4	1.3	19.1	8.6	2.7
Consumer Price Index	1.9	4.8	5.3	6.7	8.0	7.4	6.6	5.5	1.2	4.7	6.8	2.8
Federal Funds Rate (Upper Bound)	0.25	0.25	0.25	0.25	0.50	1.50	2.25	2.50	0.25	0.25	1.69	3.06
Prime Rate	3.25	3.25	3.25	3.25	3.50	4.50	5.25	5.50	3.54	3.25	4.69	6.06
10-Year Treasury Yield	1.74	1.45	1.52	1.52	2.32	3.06	2.98	2.93	0.89	1.45	2.82	2.87

Forecast as of: May 12, 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.

Forward Looking Statements

This report may contain forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Art of 1995. These statements are generally identified by words such as "outlook", "forecast", "projected", "could", "expects", "will" and other similar expressions. Examples of such forward-looking statements include, but are not limited to, statement we make about Visa's business, economic outlooks, population expansion and analyses. All statements other than statements of historical fact could be forward-looking statements, which speak only as of the date they are made, are not guarantees of future performance and are subject to certain risks, uncertainties and other factors, many of which are beyond our control and are difficult to predict. We describe risks and uncertainties that could cause actual results to differ materially from those expressed in, or implied by, any of these forward-looking statements in our filings with the SEC. Expect as required by law, we do not intend to update or revise any forward-looking statements as a result of new information, future events or otherwise.

Disclaimer

Case studies, comparisons, statistics, research and recommendations are provided "AS IS" and intended for informational purpo ses only and should not be relied upon for operational, marketing, legal, technical, tax, financial or other advice. Visa Inc. neither makes any warranty or representation as to the completeness or accuracy of the information within this document, nor assumes any liability or responsibility that may result from reliance on such information. The Information contained herein is not intended as investment or legal advice, and readers are encouraged to seek the advice of a competent professional where such advice is required.

Visa Business and Economic Insights Staff

Wayne Best, Chief Economist	wbest@visa.com
Bruce Cundiff, Vice President, Consumer Insights	bcundiff@visa.com
Michael Brown, Principal U.S. Economist	michael.brown@visa.com
Adolfo Laurenti, Principal European Economist	laurenta@visa.com
Richard Lung, Principal Global Economist	rlung@visa.com
Glenn Maguire, Principal Asia Pacific Economist	gmaguire@visa.com
Mohamed Bardastani, Senior CEMEA Economist	mbardast@visa.com
Jennifer Doettling, Director, Content and Editorial	jdoettli@visa.com
Michael Nevski, Director, Consumer Insights	mnevski@visa.com
Dulguun Batbold, Global Economist	dbatbold@visa.com
Ben Wright, U.S. Economist	bewright@visa.com
Travis Clark, U.S. Economist	wiclark@visa.com
Angelina Pascual, European Economist	anpascua@visa.com
Mariamawit Tadesse, Global Economist	mtadesse@visa.com
Woon Chian Ng, Associate Asia Pacific Economist	woonng@visa.com
Juliana Tang, Executive Assistant	jultang@visa.com

For more information, please visit us at Visa.com/Economicinsights or VisaEconomicInsights@visa.com.

Accessibility notes

Figure 1: GDP CAGR ranges from 2.4% in Mar-2019, to a low of -31.2% in Jun-2020, a high of 33.8% in Sep-2020, and the latest reading of -1.4% in Mar-2022, with the GDP CAGR forecast to finish 2022 at 2.2% and 2023 at 2.1%. YoY GDP growth ranges from 2.2% in Mar-2019 to a low of -9.1% in Jun-2020, a high of 12.2% in Jun-2021, and the latest reading of 3.6% in Mar-2022, with YoY GDP growth forecast to finish 2022 at 0.8%, and 2023 at 2.1%.

Figure 2: YoY PCE Deflator ranges from 1.7% in Mar-2020, to a low of 0.6% in Jun-2020, a high of 6.3% in Mar-2022, which is also the latest reading. The YoY PCE Deflator forecast will finish 2022 at 4.2% and 2023 at 1.8%. The YoY Core PCE Deflator ranges from 1.8% in Mar-2020 to a low of 1.0% in Jun-2020, a high of 5.2% in Mar-2022, which is also latest reading. YoY Core PCE Deflator forecast will finish 2022 at 3.6%, and 2023 at 1.7%.