

## Raising the Forecast for Short-Term Interest Rates on the Fed’s Growing Alarm Over Inflation; A Coming Economic Slowdown Will Likely Keep a Lid on Longer-Term Rates

The April *U.S. Economic Outlook* substantially raises forecasts for interest rates in 2022 and 2023 in reaction to recent changes to the Federal Reserve’s guidance. At the Fed’s March 16 meeting, the Federal Open Market Committee (“FOMC”—the policymakers who set interest rates) signaled they are prepared to raise interest rates to a restrictive level, high enough to slow growth to below the economy’s long-run potential, to bring inflation back down.

The Fed’s plans to tighten policy seem credible, even at the cost of weakening growth. FOMC members feel burned after the Fed’s professional forecasters woefully underestimated the intensity of inflation in late 2021 and early 2022. Their forecasts assumed that supply-side bottlenecks pushing up inflation—supply chain turmoil, low labor force participation, chip shortages—would ease by late 2021 and bring inflation down. But they haven’t, and inflation hasn’t either. Chair Powell now says the FOMC “will be looking to actual progress on [resolving economic bottlenecks] and not assuming significant near-term supply-side relief.” A more data-dependent monetary policy means faster tightening since the data show so much inflation—and inflation will get worse before it gets better due to the Russia-Ukraine shock and renewed lockdowns in China. The Fed is also concerned that labor demand is outstripping supply. The sum of job openings and current employment is up by 3 million since early 2020, while the labor force is roughly unchanged.

In light of this, Comerica forecasts for the Fed to raise the federal funds target by a half percentage point at their next two decisions in May and June, and by a quarter percentage point at the July, September, and December decisions. The forecast anticipates two more quarter-percentage-point hikes in the first half of 2023. By the second half of 2023, that would put the federal funds target above its peak in the last expansion, when higher interest rates contributed to a drop in residential investment, industrial production, and job openings—in other words, restricted economic growth.

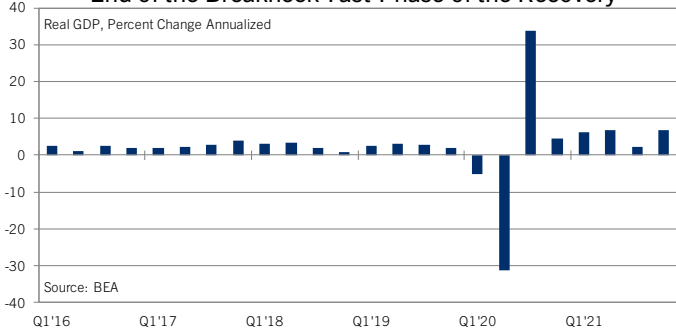
Longer-term interest rates are likely to rise less than short-term rates. This is despite the Fed beginning to unwind purchases of government-backed securities made during the pandemic, a.k.a. QE. Beginning at the May FOMC meeting, the Fed will probably start reducing bond holdings by accepting repayment on a portion of the maturing bonds. As the Fed reduces bond holdings, the Treasury will need private investors to buy more government bonds to roll over the federal debt and finance new borrowings. All things equal, more bond supply tends to push bond prices lower and bond yields higher. But, while monetary policy will be pushing longer-term interest rates up, the business cycle will be pushing them down. Economic growth will slow as inflation eats into consumer spending power and businesses finish rebuilding inventories. Oil prices will likely stabilize once the Russia-Ukraine conflict cools. As economic growth slows and commodity prices come back down, wage growth and inflation should cool as well. These factors are likely to mostly offset the Fed reducing the size of its bond holdings, limiting the rise of longer-term interest rates.

### U.S. Economic Outlook, Summary

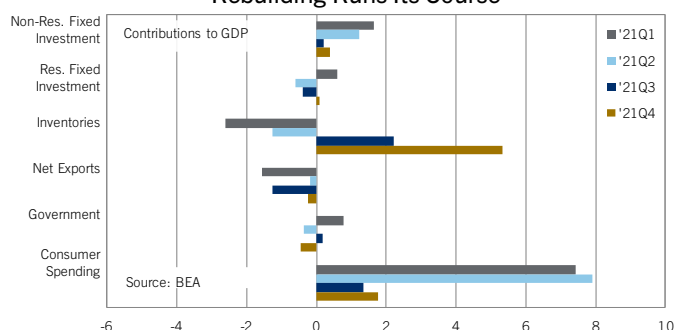
<i>a = actual    f = forecast</i>	4Q'21a	1Q'22p	2Q'22f	3Q'22f	4Q'22f	1Q'23f	2Q'23f	3Q'23f	2021a	2022f	2023f
Real GDP (Percent Change Annualized)	6.9	1.2	2.9	2.2	1.8	1.9	1.8	1.7	5.7	3.2	1.9
CPI (Percent Change Year-over-Year)	6.7	7.7	7.7	7.7	7.2	6.2	4.9	4.0	4.7	7.6	4.5
Payroll Jobs (Average Monthly Diff., Ths.)	431	562	455	355	255	168	137	116	510	407	131
Unemployment Rate (Percent)	4.2	3.8	3.7	3.7	3.7	3.7	3.6	3.6	5.4	3.7	3.6
Federal Funds Rate (Effective)	0.08	0.14	0.79	1.59	1.92	2.17	2.42	2.63	0.08	1.11	2.46
10-Yr. Treasury Rate	1.54	1.94	2.37	2.39	2.45	2.54	2.57	2.63	1.44	2.29	2.61

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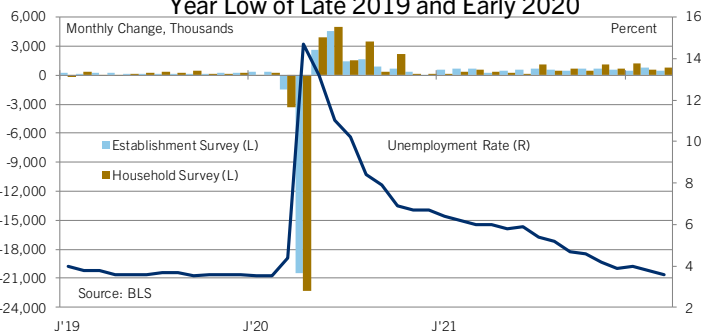
**The Fourth Quarter of 2021 Probably Marked the End of the Breakneck Fast Phase of the Recovery**



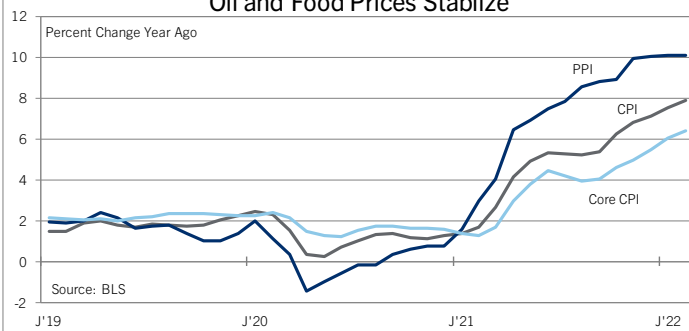
**Real GDP Growth Is Slowing in 2022 as Inventory Rebuilding Runs Its Course**



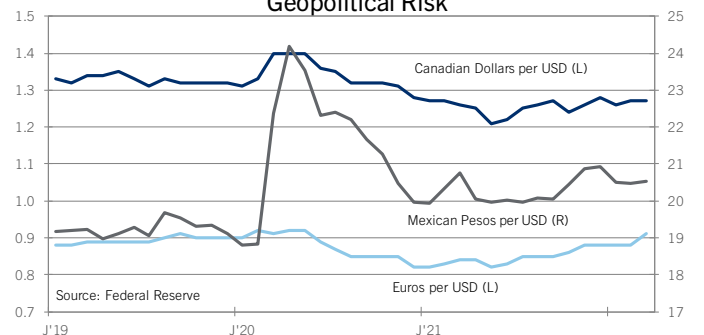
**The Unemployment Rate Is Within a Hair of the 50-Year Low of Late 1919 and Early 2020**



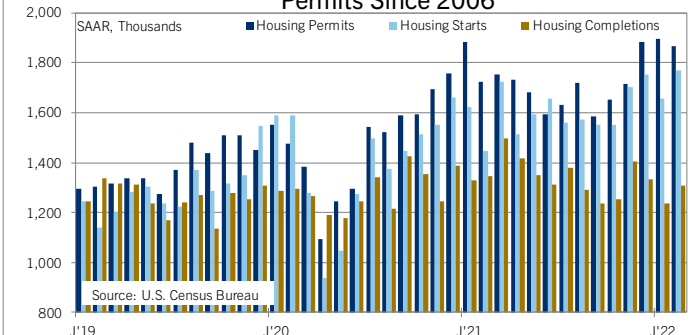
**Inflation Could Peak in the 2nd Quarter of 2022 If Oil and Food Prices Stabilize**



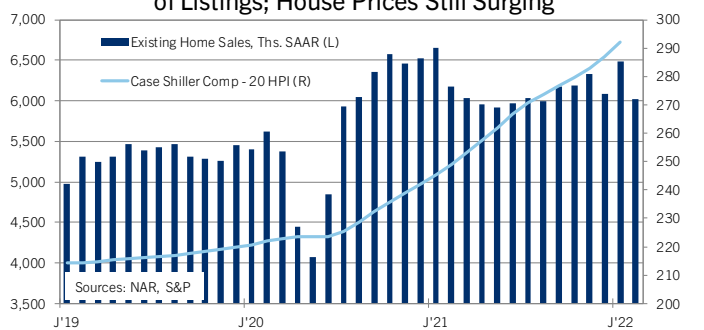
**Dollar Holding at Strong Levels Amid Heightened Geopolitical Risk**



**The Last Three Months Saw the Strongest Housing Permits Since 2006**



**Existing Home Sales Are Constrained by a Paucity of Listings; House Prices Still Surging**



**Two Steps Forward, One Step Back for Auto Sales; Working Through the Chip Shortage Is Slow Going**



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	4Q'21a	1Q'22p	2Q'22f	3Q'22f	4Q'22f	1Q'23f	2Q'23f	3Q'23f	2021a	2022f	2023f
<b>Output</b>											
Nominal GDP (Billions \$)	24008	24499	25099	25653	26030	26311	26535	26727	22998	25320	26620
<i>Percent Change Annualized</i>	<b>14.6</b>	<b>8.4</b>	<b>10.2</b>	<b>9.1</b>	<b>6.0</b>	<b>4.4</b>	<b>3.4</b>	<b>2.9</b>	<b>10.1</b>	<b>10.1</b>	<b>5.1</b>
Real GDP (Chained 2012 Billions \$)	19806	19865	20006	20117	20208	20302	20393	20481	19427	20049	20436
<i>Percent Change Annualized</i>	<b>6.9</b>	<b>1.2</b>	<b>2.9</b>	<b>2.2</b>	<b>1.8</b>	<b>1.9</b>	<b>1.8</b>	<b>1.7</b>	<b>5.7</b>	<b>3.2</b>	<b>1.9</b>
Pers. Consumption Expenditures	13843	13974	13984	14053	14141	14200	14256	14300	13631	14038	14272
<i>Percent Change Annualized</i>	<b>3.3</b>	<b>3.9</b>	<b>0.3</b>	<b>2.0</b>	<b>2.5</b>	<b>1.7</b>	<b>1.6</b>	<b>1.2</b>	<b>7.9</b>	<b>3.0</b>	<b>1.7</b>
Nonresidential Fixed Investment	2899	2930	3003	3063	3108	3141	3161	3175	2867	3026	3166
<i>Percent Change Annualized</i>	<b>2.0</b>	<b>4.3</b>	<b>10.3</b>	<b>8.2</b>	<b>6.0</b>	<b>4.4</b>	<b>2.5</b>	<b>1.8</b>	<b>7.3</b>	<b>5.5</b>	<b>4.6</b>
Residential Investment	693	710	735	744	753	756	755	749	706	735	750
<i>Percent Change Annualized</i>	<b>-0.8</b>	<b>10.0</b>	<b>15.0</b>	<b>5.0</b>	<b>5.0</b>	<b>1.6</b>	<b>-0.5</b>	<b>-2.8</b>	<b>9.0</b>	<b>4.1</b>	<b>2.1</b>
Change in Private Inventories	174	190	200	120	30	-20	-40	-40	-38	135	-30
Net Exports	-1338	-1490	-1486	-1451	-1424	-1389	-1361	-1337	-1281	-1463	-1351
Government Expenditures	3357	3371	3386	3405	3417	3429	3439	3449	3376	3395	3444
<i>Percent Change Annualized</i>	<b>-2.9</b>	<b>1.7</b>	<b>1.8</b>	<b>2.2</b>	<b>1.5</b>	<b>1.4</b>	<b>1.1</b>	<b>1.2</b>	<b>0.5</b>	<b>0.6</b>	<b>1.4</b>
Industrial Prod. Index (2007=100)	101.8	103.0	104.6	105.4	105.6	104.7	103.7	103.8	100.2	104.7	104.1
<i>Percent Change Annualized</i>	<b>4.4</b>	<b>5.0</b>	<b>6.3</b>	<b>2.9</b>	<b>1.0</b>	<b>-3.4</b>	<b>-4.1</b>	<b>0.4</b>	<b>5.5</b>	<b>4.5</b>	<b>-0.5</b>
Capacity Utilization (Percent)	76.5	77.0	77.7	78.0	77.9	77.1	76.0	75.5	75.4	77.7	76.0
<b>Prices</b>											
CPI (1982-84=100)	278.4	283.9	289.5	294.3	298.6	301.5	303.8	306.1	271.0	291.6	304.8
<i>Percent Change Annualized</i>	<b>7.9</b>	<b>8.1</b>	<b>8.2</b>	<b>6.7</b>	<b>6.0</b>	<b>3.9</b>	<b>3.2</b>	<b>2.9</b>	<b>4.7</b>	<b>7.6</b>	<b>4.5</b>
PCE Price Index (2012=100)	118.1	120.4	122.7	124.7	126.4	127.5	128.5	129.3	115.5	123.5	128.8
<i>Percent Change Annualized</i>	<b>6.3</b>	<b>8.0</b>	<b>7.9</b>	<b>6.8</b>	<b>5.6</b>	<b>3.7</b>	<b>3.0</b>	<b>2.6</b>	<b>3.9</b>	<b>6.9</b>	<b>4.3</b>
GDP Price Index (2012=100)	121.3	123.5	125.7	127.8	129.1	129.9	130.4	130.8	118.5	126.5	130.6
<i>Percent Change Annualized</i>	<b>7.1</b>	<b>7.2</b>	<b>7.3</b>	<b>6.9</b>	<b>4.2</b>	<b>2.5</b>	<b>1.6</b>	<b>1.2</b>	<b>4.2</b>	<b>6.8</b>	<b>3.2</b>
PPI, Final Demand (Nov. 2009=100)	131.0	135.0	139.5	143.2	145.8	147.1	148.0	148.7	126.7	140.9	148.3
<i>Percent Change Annualized</i>	<b>8.4</b>	<b>12.9</b>	<b>13.9</b>	<b>10.9</b>	<b>7.5</b>	<b>3.5</b>	<b>2.5</b>	<b>2.2</b>	<b>3.9</b>	<b>8.2</b>	<b>5.1</b>
Crude Oil, WTI (\$/barrel)	77.1	95.0	110.0	110.0	110.0	95.0	90.0	87.0	67.6	106.3	89.3
<b>Labor Markets</b>											
Payroll Jobs (Average Monthly Diff., Ths.)	431	562	455	355	255	168	137	116	510	407	131
Unemployment Rate (Percent)	4.2	3.8	3.7	3.7	3.7	3.7	3.6	3.6	5.4	3.7	3.6
Average Weekly Hours	34.8	34.6	34.6	34.6	34.6	34.6	34.6	34.6	34.8	34.6	34.6
Population (Millions)	333.0	333.6	334.1	334.7	335.3	335.9	336.4	337.0	332.1	334.4	336.7
<i>Percent Change Annualized</i>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>
<b>Personal Income</b>											
Average Hourly Earnings (\$)	31.25	31.64	32.11	32.63	33.07	33.43	33.76	34.05	30.60	32.36	33.88
<i>Percent Change Annualized</i>	<b>6.2</b>	<b>5.1</b>	<b>6.1</b>	<b>6.6</b>	<b>5.5</b>	<b>4.5</b>	<b>4.0</b>	<b>3.5</b>	<b>4.2</b>	<b>5.8</b>	<b>4.7</b>
Real Disp. Income (2012 Billions \$)	15417	15197	15143	15153	15179	15210	15239	15254	16021	15168	15241
<i>Percent Change Annualized</i>	<b>-5.6</b>	<b>-5.6</b>	<b>-1.4</b>	<b>0.2</b>	<b>0.7</b>	<b>0.8</b>	<b>0.8</b>	<b>0.4</b>	<b>2.2</b>	<b>-5.3</b>	<b>0.5</b>
Personal Saving Rate (Percent)	7.6	6.3	6.3	6.4	6.5	6.6	6.7	6.8	12.0	6.4	6.7
<b>Housing</b>											
Housing Starts (Ths., Ann. Rate)	1654	1743	1776	1800	1820	1830	1837	1844	1601	1785	1840
Exst. SF Home Sales (Ths., Ann Rate)	5513	5546	5639	5721	5829	5926	5970	5999	5418	5684	5980
New SF Home Sales (Ths., Ann Rate)	752	780	790	800	811	820	826	832	771	795	829
Case/Shiller HPI (Jan. 2000=100)	276.3	288.0	298.2	304.7	309.2	312.6	314.9	316.6	260.0	300.0	315.5
<i>Year/Year Percent Change</i>	<b>18.9</b>	<b>18.9</b>	<b>17.1</b>	<b>14.1</b>	<b>11.9</b>	<b>8.5</b>	<b>5.6</b>	<b>3.9</b>	<b>17.0</b>	<b>15.4</b>	<b>5.2</b>
<b>Consumer</b>											
Consumer Confidence* (Conference Board)	112.9	108.0	96.9	101.5	103.9	105.7	112.8	113.5	112.7	102.6	111.7
Car and Light Truck Sales (Millions)	13.0	14.1	14.5	15.5	16.2	16.6	17.2	17.6	15.0	15.1	17.4
<b>Interest Rates (Percent)</b>											
Federal Funds Rate (Effective)	0.08	0.14	0.79	1.59	1.92	2.17	2.42	2.63	0.08	1.11	2.46
Prime Rate	3.25	3.28	3.89	4.69	5.02	5.27	5.52	5.73	3.25	4.22	5.56
1-Month LIBOR	0.09	0.22	0.94	1.74	2.08	2.32	2.57	2.79	0.10	1.25	2.62
3-Month LIBOR	0.16	0.50	1.35	1.95	2.21	2.44	2.68	2.83	0.16	1.50	2.69
1-Yr. Treasury Rate	0.20	0.93	1.77	2.14	2.36	2.52	2.60	2.65	0.10	1.80	2.60
5-Yr. Treasury Rate	1.18	1.81	2.51	2.56	2.62	2.70	2.65	2.58	0.86	2.38	2.62
10-Yr. Treasury Rate	1.54	1.94	2.37	2.39	2.45	2.54	2.57	2.63	1.44	2.29	2.61
30-Yr. Fixed Rate Mortgage	3.08	3.84	4.61	4.74	4.73	4.70	4.60	4.51	2.96	4.48	4.58

a = actual p = preliminary f = forecast

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