Contact: Victoria Pike Bond
Phone: 415-488-7195
Email: Victoria@BeaconEcon.com

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STORM CLOUDS FORMING: CHANCE OF RECESSION HIGH… IT'S COMING, BUT NOT QUITE YET

Federal Reserve Moves Are Too Little Too Late And Unlikely To Avert A Hard Landing

Labor Force Squeeze Acute In California

June 9, 2022—LOS ANGELES, CALIFORNIA — The overheated U.S. economy is edging ever closer to a serious contraction, which would bring to an end the over decade-long expansionary period that began after the 2008-09 Great Recession, according to **Beacon Economics**' latest outlook for the United States and California. The $12 trillion injected into the U.S. economy over a two-year period during the pandemic caused wealth in the nation to surge, which drove spending and investment to unsustainable levels. That *over* stimulus is coming home to roost, we just don't know when.

"The trillion-dollar questions are when will a recession likely begin and how bad will it be; timing wise, certainly not yet," said **Christopher Thornberg**, Founding Partner of Beacon Economics and one of the forecast authors. "Near-term, the economy's expansion still has momentum, driven by historically high household savings, low private sector debt levels, and the fact that policymakers have yet to truly withdraw stimulus funding."

The new forecast argues that although U.S. output contracted in the first quarter of the year, it was not driven by weak spending—in fact, final demand in the nation grew at its fastest clip in three quarters. Rather, the contraction was driven by the recent and enormous surge in imports that replaced domestic production—another sign of an overheated economy, not a contracting one.

To date, the tightening actions taken by the Federal Reserve have been tantamount to baby steps and will have minimal impact on demand, and therefore inflation, according to the outlook. "The Fed must do far more, and quickly, before inflation becomes an even more endemic problem," says Thornberg. "They need to get serious about shrinking their balance sheet, and Congress needs to focus on balancing the U.S. budget. Unfortunately, this is unlikely on both fronts because public sentiment suggests we are on the edge of a cliff—and no policymaker wants to be the pusher."

Indeed, the surge in public panic over the economy is liable to prevent the Fed and Congress from doing what they need to do to cool things off, meaning the problems associated with an overheating economy will grow worse, and when a recession does arrive it will be more severe than if the issue had been tackled quickly and assertively, according to the forecast.

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Key Findings:

- Despite some headlines, the pandemic-driven recession is undoubtedly over. With a 3.6% unemployment rate, record low inventories, and the highest pace of industrial production ever it's clearly evident that the U.S economy is currently operating at full capacity.

- The nation's unit money supply (M2 relative to the size of the nominal economy) has never been higher, which suggests the United States will see even *more* inflation unless something is done to shrink the money supply back to size.

- Net worth among the bottom 50% of earners increased 90% in the last two years, although wealth inequality in the nation remains far too high. At the same time, Americans paid off a great deal of debt or refinanced mortgages at ultra-low rates. The debt burden on U.S. households is much lower than it's ever been – a good thing when a recession hits.

- Supply chain problems are showing in the form of labor shortages. The great retirement that occurred over the course of the pandemic saw almost 3 million U.S. workers drop out of the labor force. Now there are a record 11 million job openings and demand for workers is causing wages to rise at their fastest pace in 30 years.

- One of the most worrisome trends is the U.S. trade deficit, which, as of the first quarter of this year, is running at 5% of GDP, another way of saying the nation is consuming 5% more than it is producing. The United States "borrowed" a net $300 billion from the rest of the world in the first quarter alone to fuel this excess consumption.

- Many of California's regions now have lower unemployment rates than they did pre-pandemic. This includes all of the state's major employment centers across southern, northern, and inland California.

- California's labor market recovery has been stronger in the inland parts of the state, due in large part to the heavy presence of the Logistics sector. Employment in this sector is now 18% higher than pre-pandemic, fueled by the continued and accelerated transition to online consumption.

- California's labor force – defined as the number of people either employed or seeking employment – is still 1.5% below pre-pandemic levels. But the squeeze is tighter in some regions: The Inland Empire, Sacramento, San Diego, and San Jose have completely recovered, while Ventura, Los Angeles, and San Francisco have the largest workforce deficits. "As is clear to anyone who visits a restaurant or retail store in many parts of California, where "now hiring" signs are abundant, the state is currently experiencing an acute labor shortage," said **Taner Osman**, Research Manager at Beacon Economics and one of the forecast authors.

- In the first quarter of 2022, home prices in California averaged $685,000, an increase of 13% on a year-over-year basis. That price is close to double the median price in the nation.

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