AgCountry Farm Credit Services
Economic Review

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Q4 2022 ECONOMIC REVIEW
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The focus of the economy continues to be on inflation and the resulting actions of the Federal Reserve. Personal Consumption Expenditures Price Index (PCE) inflation remains above the Federal Reserve target and as a result the Fed has increased the Federal Funds rate continuously since the March 2022 Federal Open Market Committee (FOMC) meeting.

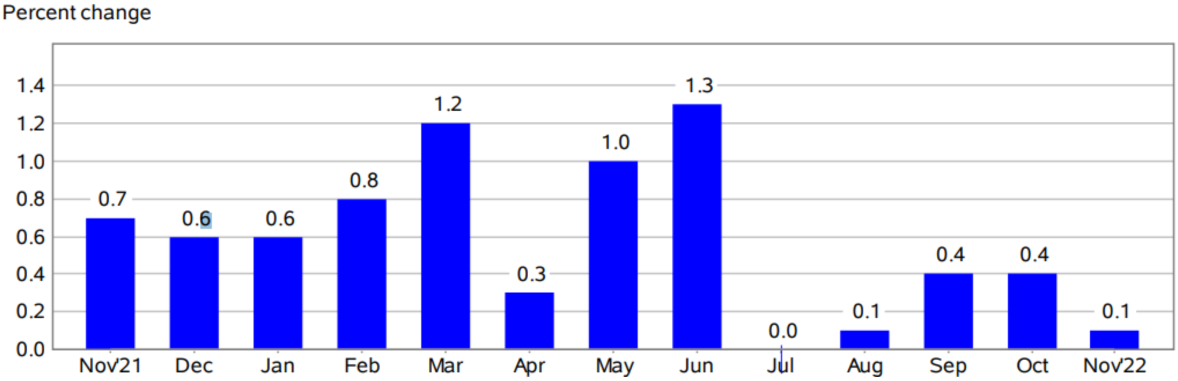
FOMC Target Federal Funds Rate -2022

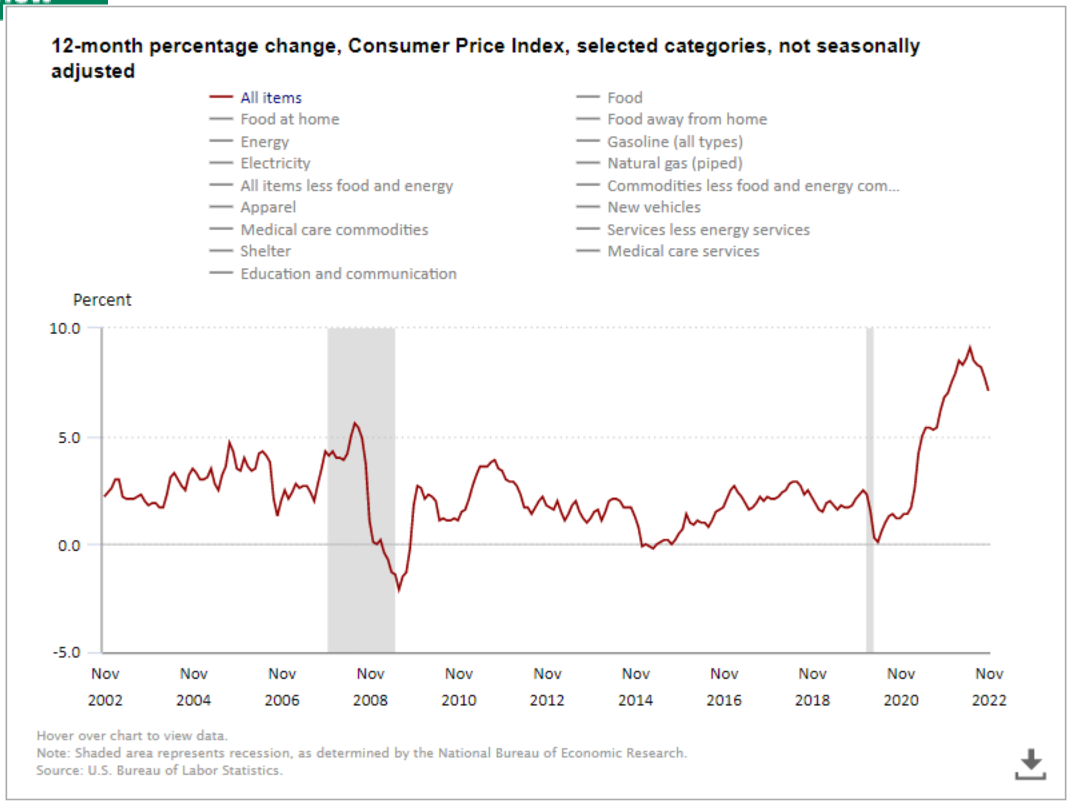
Date	Increase	Decrease	Level (%)
December 15	50	0	4.25-4.50
November 3	75	0	3.75-4.00
September 22	75	0	3.00-3.25
July 28	75	0	2.25-2.50
June 16	75	0	1.50-1.75
May 5	50	0	0.75-1.00
March 17	25	0	0.25-0.50

MONETARTY POLICY & INFLATION:

The U.S. Bureau of Labor Statistics reported on December 13, 2022, that the Consumer Price Index for All Urban Consumers (CPI-U) increased 0.1% in November after increasing 0.4% in October. The all-items index increased 7.1% for the last 12 months. The index for shelter was the largest contributor to the monthly all items increase, offsetting decreases in energy indexes. The food index increased 0.5% over the month with the food at home index also rising 0.5%. The energy index decreased 1.6% over the month as the gasoline index, the natural gas index, and the electricity index all declined.

Chart 1. One-month percent change in CPI for All Urban Consumers (CPI-U), seasonally adjusted, Nov. 2021 - Nov. 2022





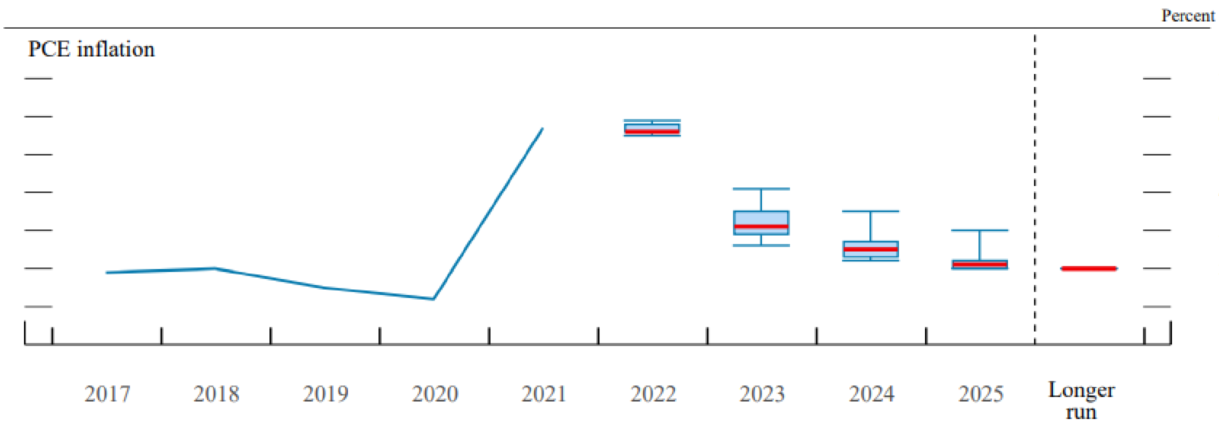
The Federal Reserve shifted their stance on inflation from transitory inflation caused by supply and demand imbalances created by the pandemic to systemic inflationary pressures, namely oil prices, caused by the Russian invasion of Ukraine and continued supply chain disruptions. In a fourth quarter 2022 survey conducted by the Philadelphia Federal Reserve, professional forecasters estimated that fourth quarter headline CPI inflation will average 5.4% (annual rate), which is up from their forecast of 4.3% in the previous survey. Moody's Baseline forecast for December has 2022 CPI at 8.1% in 2022 and 4.1% in 2023.

Federal Reserve Governor Lisa D. Cook January 6, 2023 "Thoughts on Inflation in a Supply-Constrained Economy"

"Inflation remains far too high, despite some encouraging signs lately, and is therefore of great concern. As a Fed policymaker, I am committed to bringing inflation back to our 2 percent goal.

The 12-month change in total personal consumption expenditures (PCE) prices through November was 5.5 percent. Core PCE prices rose 4.7 percent over the same 12-month period (figure 1). This measure omits volatile food and energy prices and tends to give a more accurate signal of total inflation's trajectory. Both figures are down a bit from the peaks reached in the first half of last year. However, monthly data are quite volatile, so I would caution against putting too much weight on the past few favorable monthly data reports."

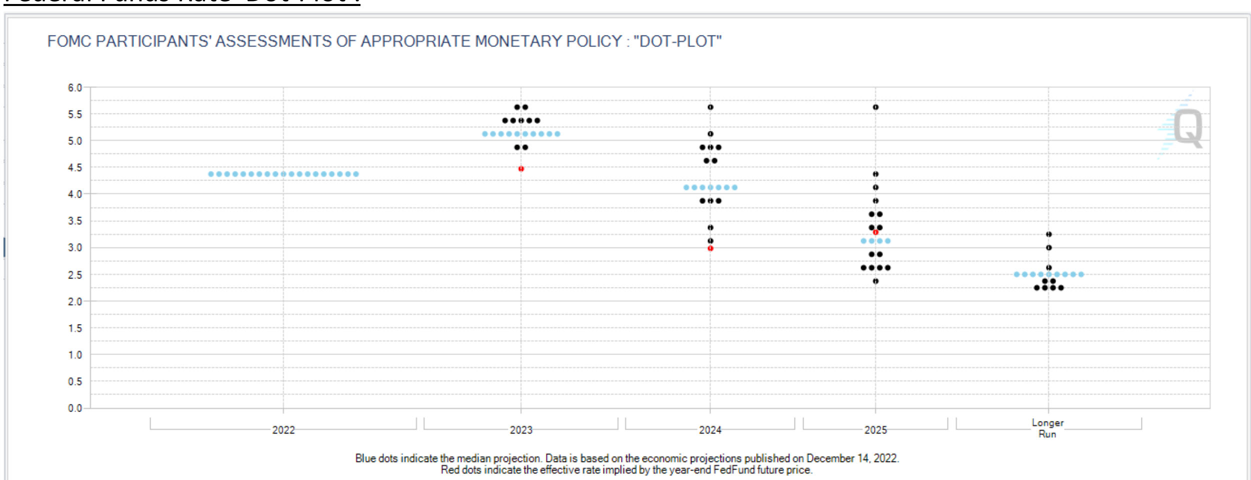
Federal Reserve Summary of Economic Projections:



- The chart above displays the Federal Reserve Governors projection for PCE an inflation indicator used by the Federal Reserve. The medians, central tendencies, and ranges are included for the next three years as well as the longer run expectations.

The Federal Reserve no longer considers inflation transitory and is now aggressively tightening monetary policy. At the most recent FOMC meeting December 15th, the committee raised the federal funds rate by 0.50% for a target of 4.25-4.50%. In addition to raising the Fed Funds Rate, the committee will continue reducing its holdings of Treasury securities, agency debt, and agency mortgage-backed securities. The Committee reiterated that they are strongly committed to returning inflation to its 2% objective. Moody's Analytics expects the Federal Reserve to increase the funds rate 50 basis points at the November and 25 basis points at each of the January and March 2023 meeting of the Federal Open Market Committee. Moody's terminal fed funds rate projection in 2023 is just below 5% and they expect the Fed to start cutting interest rates in late 2023 and throughout 2024.

<u>Federal Funds Rate 'Dot-Plot':</u>



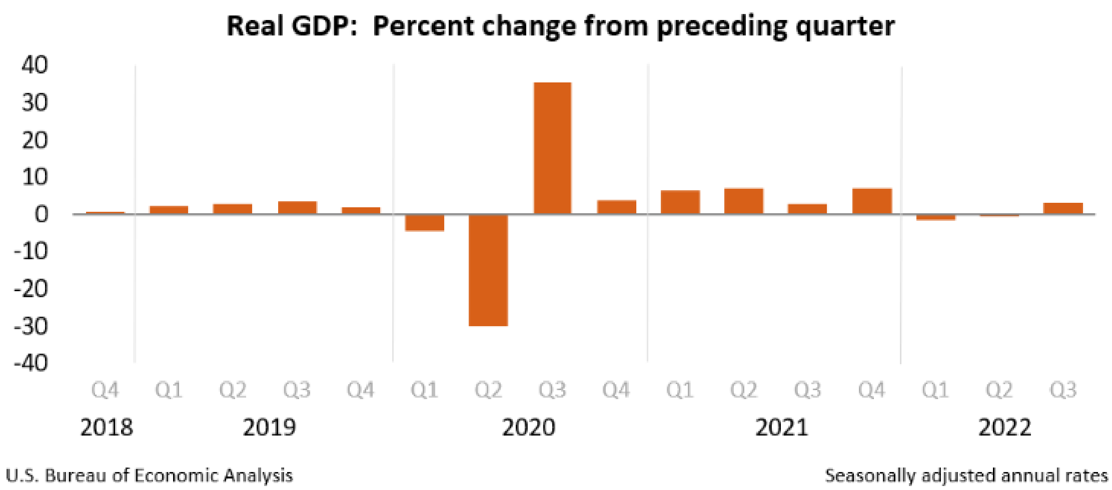
Blue dots indicate the median projection. Data is based on the economic projections published on December 14, 2022.
Red dots indicate the effective rate implied by the year-end FedFund future price.

Note: Each shaded circle indicates the value (rounded to the nearest 1/8 percentage point) of an individual participant's judgment of the midpoint of the appropriate target range for the federal funds rate or the appropriate target level for the federal funds rate at the end of the specified calendar year or over the longer run. One participant did not submit longer-run projections for the federal funds rate.

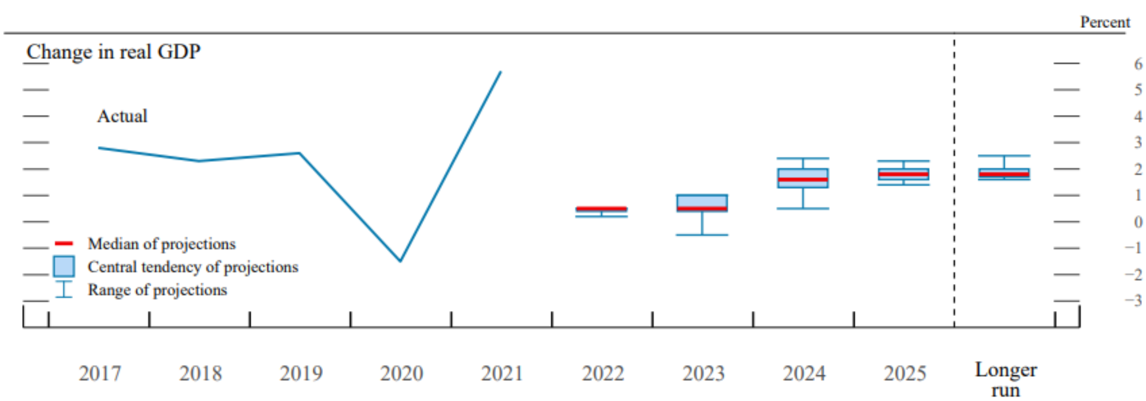
The chart above is referred to as the Federal Reserve "Dot-Plot" and represents the forward-looking fed-funds rate expectations for each of the members of the Federal Reserve. The group expects interest rates to continue to rise in 2023 but the lack of consensus in 2024 suggests difference of opinions on how quickly inflation will be reduced.

GROSS DOMESTIC PRODUCT:

After the sharp decline in Gross Domestic Product (GDP) during the second quarter of 2020, GDP growth rebounded quickly and continued to grow until the first quarter of 2022. After an increase of 6.9% in the fourth quarter of 2021, GDP declined both in the first and second quarters of 2022 by 1.6% in the first quarter and 0.6% second quarter. GDP increased at an annual rate of 3.2% in the third quarter, which reflected increases in exports and consumer spending. The chart below displays the trend in quarterly GDP growth over the last five years. Moody's December Baseline forecasts GDP growth of 1.6% in the fourth quarter of 2022 and 1.9% for the year. Moody's also expects GDP growth of 0.9% in 2023 and 2.0% in 2024.



Federal Reserve Summary of Economic Projections:



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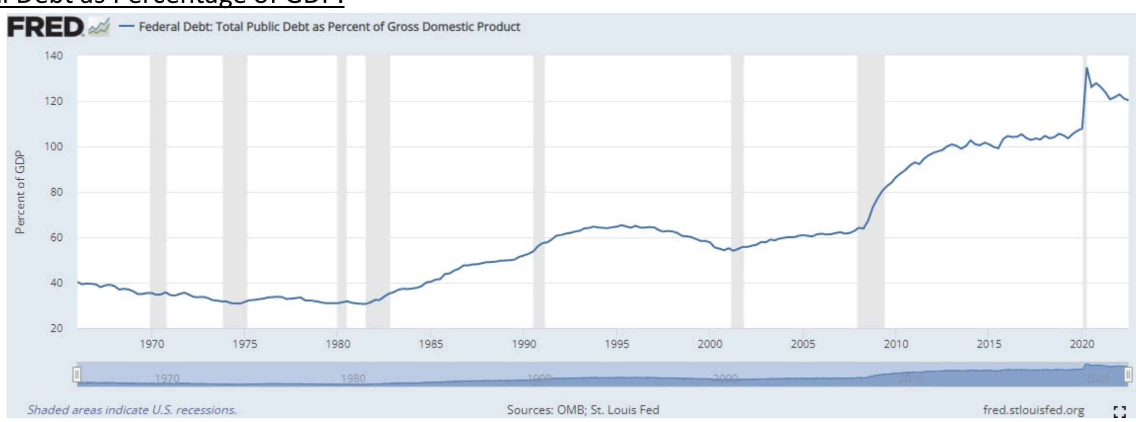
- The chart above displays the Federal Reserve Governors projection for GDP. The medians, central tendencies, and ranges are included for the next three years as well as the longer run expectations.

FISCAL POLICY:

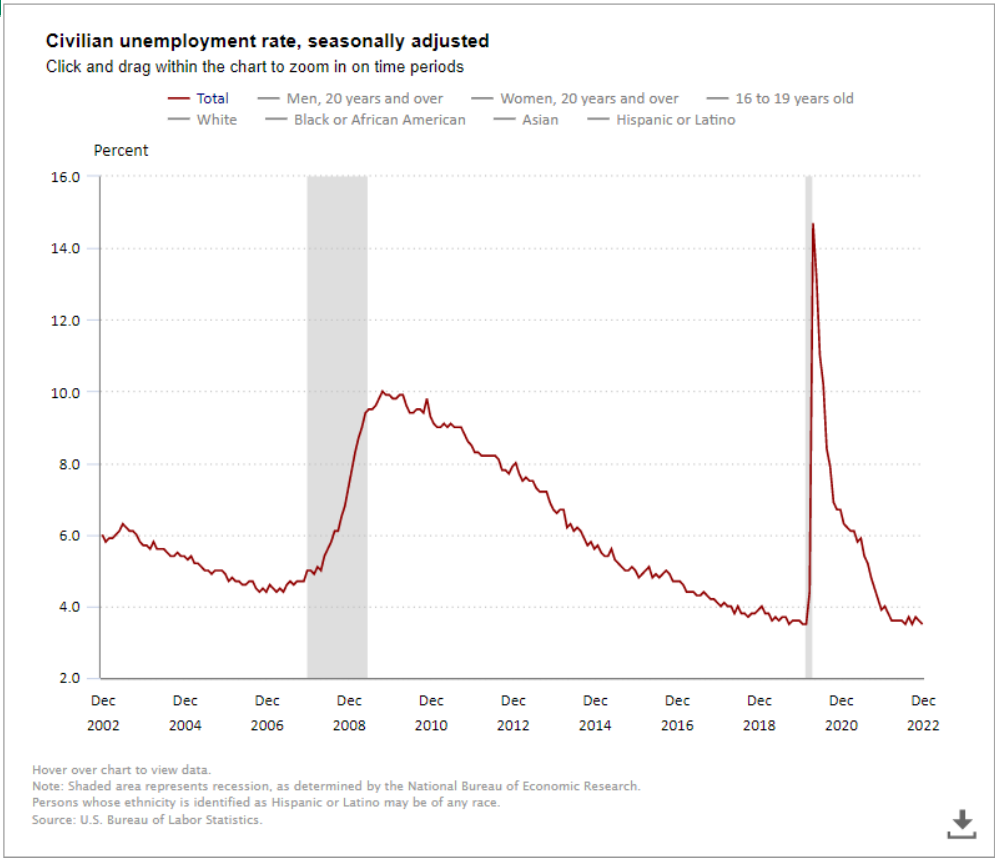
Fiscal support since the beginning of the pandemic will ultimately total more than $5 trillion, equivalent to nearly 25% of 2019 GDP and approximately three times the support provided during the global financial crisis. If the highly expansionary, deficit-financed discretionary fiscal policy continues it will provide a boost to the economy but also fuel further inflation. The federal government posted a deficit of $2.8 trillion in fiscal 2021 and nearly a $1.4 trillion deficit in fiscal 2022. The deficit is expected to narrow to $850 billion in 2023. The publicly traded Debt-to-GDP ratio breached 100% and Moody's expects it to reach 112% in fiscal 2023.

Total Debt as Percentage of GDP:

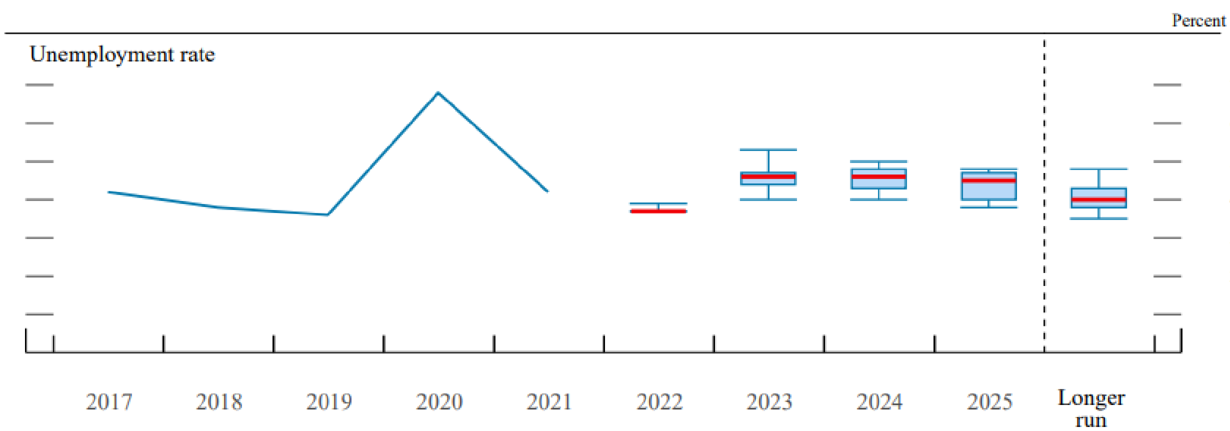


EMPLOYMENT:

Total nonfarm employment rose by 223,000 in December. The unemployment rate declined slightly from 3.7% in November to 3.5% in December. The number of unemployed declined to 5.7 million, which is that same level of unemployed as February 2020. Moody's expects weaker job growth in 2023 because of possible recession and the weaker pace of job growth in 2023 to cause the unemployment rate to increase to 4.2% in the first quarter of 2024.



Federal Reserve Summary of Economic Projections -December:



The above chart shows the Federal Reserve medians, central tendencies, and ranges for the unemployment rate in the short and long term. Unemployment is expected to be in a range from 3.7% to 3.9% in 2022 with the majority of members expecting 3.7%. The Federal Reserve's outlook for 2023 unemployment has increased slightly from their September 2022 projections of 4.1 – 4.5% to 4.4 – 4.7% in their December projections.

CONCLUSION:

The economy has rebounded from pandemic-related disruptions but is now faced with new inflation headwinds stemming from years of accommodative monetary policy, unprecedented fiscal stimulus, supply chain interruptions, and the Russian/Ukraine war. Full employment has been reached and inflation has extended beyond supply chain concerns. After recognizing the inflation concerns the Federal Reserve is focused on tightening monetary policy to reduce inflation. However, the necessary monetary tightening will likely have negative impacts on GDP growth and employment. The Federal Reserve will need to balance their goal of bringing inflation down to their 2% target without causing a severe recession.

SOURCES:

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