

United States economic outlook

2022 year-in-review
and early 2023 developments



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2022 year-in-review
and early 2023 developments



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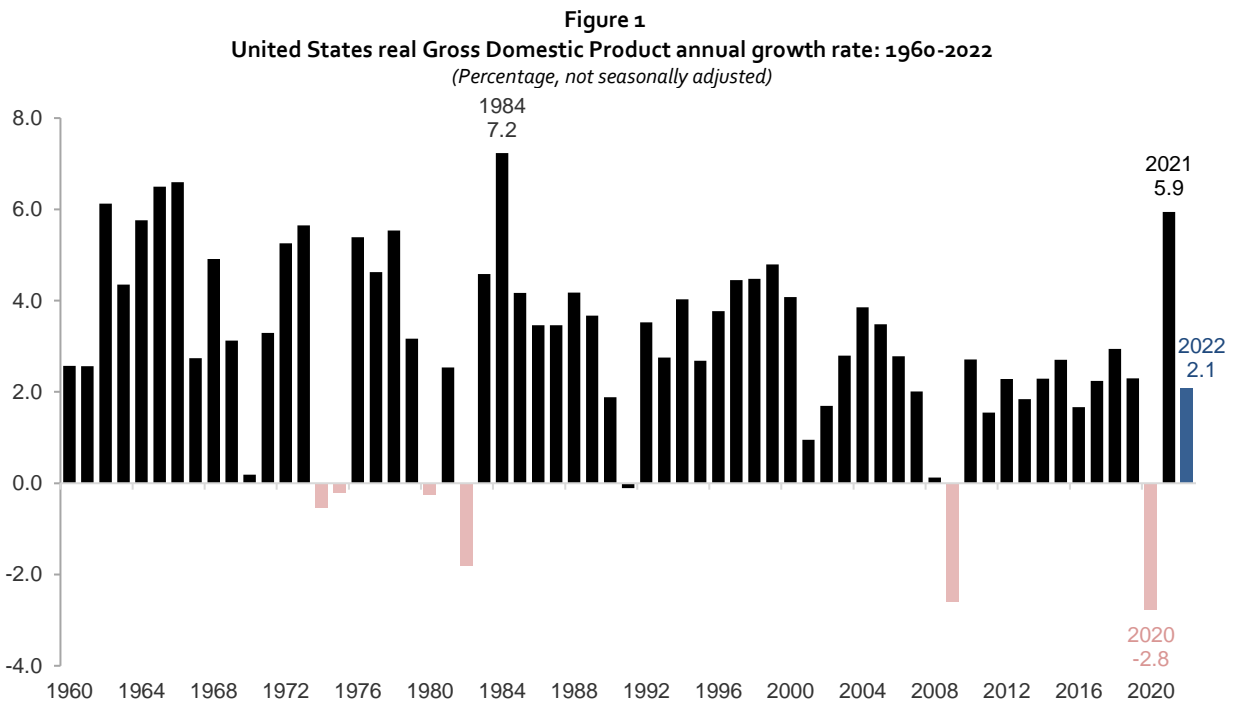
Highlights

- *The United States Gross Domestic Product (GDP) rose 2.1% in 2022.* Consumer spending was the main driver, contributing 1.9% to annual growth. The economic outlook improved in the second half of 2022, following two quarters of negative growth in the first half. Momentum has carried over into early 2023.
- *The labor market was strong in 2022 and continued to show strength in early 2023.* In 2022, an average of 399,000 new jobs were created per month and 4.8 million new jobs were added on an annual basis. The labor market has remained strong, adding over one million new jobs in the first quarter of 2023, with an average of 345,000 jobs per month.
- *Inflation rose 8% in 2022, the highest annual level in four decades.* It slowed to 5% in March 2023 from 6.5% in December 2022, building on a trend of moderating price increases that started after a peak of 9.1% was reached in June 2022. Core inflation, which excludes volatile energy and food categories, rose 5.6% in March, a slight increase from 5.5% in February. Although it has eased from a peak of 6.6% in September 2022, the March uptick shows underlying price pressures remain elevated. The rapid pace of price increases in 2022 added pressure on the Federal Reserve to raise rates aggressively to tame inflation.
- *The Federal Reserve raised interest rates seven times in 2022, at the most aggressive pace since the 1980s,* with the goal of slowing the economy enough to curb inflation. Interest rates were raised two more times in early 2023, with quarter-point increases on 1 February and 22 March 2023. The federal funds rate increased from near zero in March 2022 to roughly 5% in March 2023, the fastest increase on record.
- *The sudden collapse of Silicon Valley Bank (SVB) in March 2023 was partly driven by assets that lost value when interest rates rose from near zero.* Fixed-rate securities made up nearly 60% of SVB's assets at the end of 2022. As interest rates increased, those bonds became less valuable. As the vast majority of the bank's deposits were uninsured, it was particularly vulnerable to fears of a bank run that became self-fulfilling. The bank's customers withdrew US\$ 42 billion in just 24 hours, forcing SVB to sell its securities at a large loss. The collapse, which was followed by another bank failure (Signature Bank), reverberated through the banking sector domestically and abroad.

- *Despite the recent stress in the banking sector, the Federal Reserve remained focused on bringing inflation down to target in its 22 March 2023 meeting. With the economy adding over one million jobs in the first quarter of 2023 and inflation still high, the Fed chose to remain vigilant regarding inflation, approving a quarter point interest rate increase.*
- *Potential cascading effects of bank failures and increased market stress have elevated uncertainty about the central bank's next steps and where the United States economy is headed. While recent growth and job figures point to economic resilience and inflation continues to slow, the odds of a recession over the next 12 to 18 months appear to have increased with the recent stress in the banking sector and financial markets. Risk of policy moves causing a sharper slowdown has also risen.*
- *Unease about the banking system's stability and a stalemate over raising the debt limit are intensifying an already elevated level of financial anxiety, as the two economic challenges become intertwined. Facing both challenges simultaneously, the United States Congress could contribute to further economic uncertainty.*

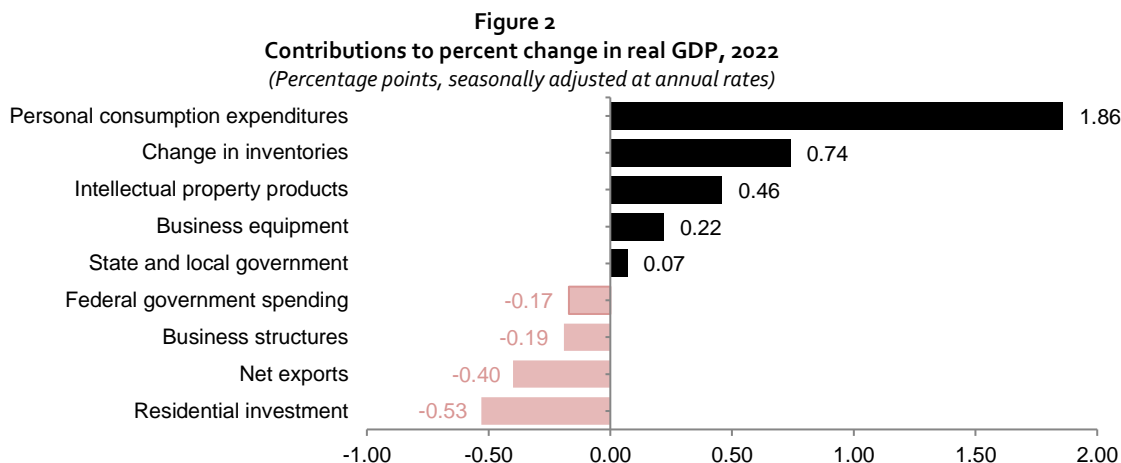
Overview

The United States Gross Domestic Product (GDP) rose 2.1% in 2022, a weaker annual growth than in 2021, which had been the strongest since 1984 (figure 1). Consumer spending was the main driver of the GDP annual increase, contributing 1.9% to growth in 2022 (figure 2).



Source: Federal Reserve Economic Data, FRED Graph Observations, Gross Domestic Product by Expenditure in Constant Prices: Total Gross Domestic Product for the United States, Growth Rate Previous Period, Annual, Not Seasonally Adjusted.

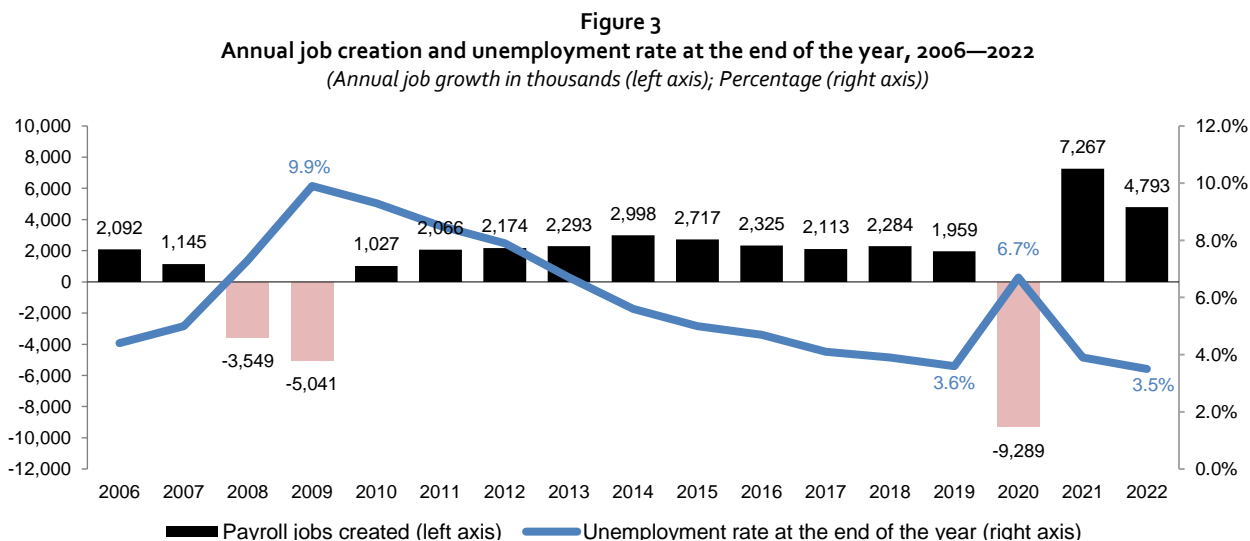
According to the United States Bureau of Economic Analysis (BEA), the increase in real GDP in 2022 reflected increases not only in consumer spending but also in exports, private inventory investment, and nonresidential fixed investment. They were partly offset by decreases in residential fixed investment and federal government spending. Imports increased more than exports, thus trade’s contribution to annual growth was negative.



Source: ECLAC Washington Office based on data from the Bureau of Economic Analysis, U.S. Department of Commerce.

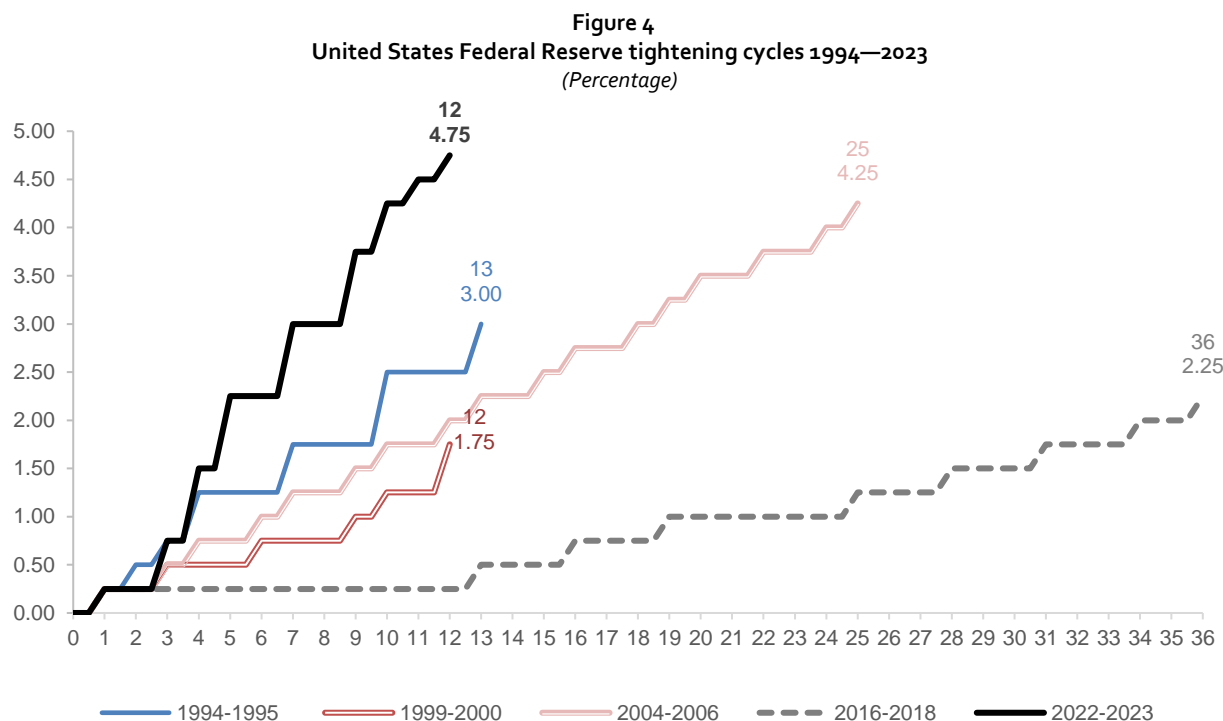
Rising interest rates weighed on growth in 2022, as the Federal Reserve acted to contain inflation. Inflation in 2022 was 8%, the highest annual inflation since 1981. After reaching a 9.1% peak in June 2022, the Consumer Price Index (CPI) slowed to 5.0% in March 2023 from a year earlier. Core inflation (excluding food and energy prices) was 6.2% in 2022, the highest since 1982. It was at 5.6% in March 2023, a slight uptick from 5.5% in February. Although core inflation has eased from a peak of 6.6% in September 2022, this uptick shows underlying price pressures remain elevated. Wages have increased as job openings have exceeded the number of unemployed persons for the past year, but the strength of inflation is offsetting gains in workers’ pay—average hourly earnings were up 4.2% in March 2023, still below headline inflation.

The labor market was strong in 2022 and continued to show strength in early 2023. In 2022, an average of 399,000 new jobs were created per month and 4.8 million new jobs were added on an annual basis, while the unemployment rate ended the year at a historic low of 3.5% (figure 3).



Source: ECLAC Washington Office based on data from the United States Bureau of Labor Statistics.

Labor market strength continued in the first quarter of 2023, with over one million new jobs being added at an average of 345,000 jobs per month. The unemployment rate fell to 3.5% at the end of March from 3.6% in February. The labor market remains resilient in face of the fastest pace of monetary policy tightening since the early 1980s (figure 4).



Source: ECLAC Washington Office, based on data from the United States Federal Reserve.

The Federal Reserve approved nine interest rate increases from March 2022 to March 2023—from 0.00%–0.25% to 4.75%–5.00%—including four consecutive 0.75 percentage point increases from June to November 2022, as well as a plan to shrink its US\$ 9 trillion asset portfolio to combat inflation. The Federal Reserve enacted its ninth straight interest rate increase on 22 March 2023. This latest increase came after the sudden collapse of Silicon Valley Bank (SVB), which was partly driven by assets that lost value when interest rates rose from near zero.

In recent years, banks received a wave of new deposits from pandemic-era savings and stimulus and increased their assets with bonds and other fixed-rate investments such as Treasury notes and mortgage-backed securities. At SVB, fixed-rate securities made up nearly 60% of the bank's assets at the end of 2022, which became less valuable as interest rates increased. In addition, the vast majority of its deposits were uninsured, making the bank particularly vulnerable to fears of a bank run that became self-fulfilling. The bank's customers withdrew US\$ 42 billion in just 24 hours, forcing SVB to sell its securities at a large loss on 10 March 2023, causing it to collapse. It was the second-largest bank failure in the United States history in terms of asset value, and the largest since the 2007-2008 financial crisis. Risk management failures, as bank executives failed to address clear interest-rate and liquidity risks, and regulatory failures, have been raised as contributing factors to the bank's collapse, which has led to turmoil in the banking sector.

Following the collapse of SVB, Signature Bank also collapsed. They were the two main banks for crypto companies, with SVB having crypto startups and venture capitalists as customers. The banks' collapse came just days after the shutdown of the crypto lender Silvergate Capital Corp. However, what started as a specific plight to crypto-currency focused banks, rapidly morphed into a crisis with economic, political and international repercussions. Investors soon grew increasingly concerned about First Republic Bank and Credit

Suisse Group.¹ A more in-depth discussion of what happened can be found in section H of this report, while the policy response is discussed in section F.

In face of the recent banking sector turmoil, investors are weighing prospects for a pause in interest rate increases against the resilience of current economic data suggesting tighter monetary policy may be needed for longer. The U.S. economy ended 2022 on a stronger note. Real gross domestic product (GDP) increased at an annual rate of 2.6% in the fourth quarter of 2022, according to the third estimate released by the Bureau of Economic Analysis on 30 March 2023, following a 3.2% increase in the third quarter.

Momentum has carried over into early 2023 and fueled speculation that a higher terminal interest rate (the rate at which the Fed will stop hiking) and a longer period of interest rate increases might be needed to bring inflation back to target. At their meeting in March 2023, which took place after the SVB and Signature Bank's collapses and First Republic Bank's private sector rescue, Fed officials' median estimate for the federal funds rate peak this year was 5.1% (unchanged from its earlier estimate made in December 2022), and 4.3% in 2024 (higher than the December 4.1% estimate). Seven out of eighteen officials see rates rising even higher in 2023.

The banking sector stress and financial volatility have added uncertainty to the future path of interest rates, however. A tightening in credit conditions is now expected, which would weigh on economic activity. Market forecasters anticipate that U.S. economic growth will come to a halt in the second half of 2023, as the effects of higher interest rates and tighter credit conditions take hold. On average, with market forecasts made in the second half of March 2023, the U.S. economy is projected to grow 1.3% in the first quarter, 0.4% in the second, and stay flat in the second half of 2023 (table 1).

Table 1
Quarterly forecasts for United States economic growth in 2023
(Percentage change)

	Q1 2023 (qoq)	Q2 2023 (qoq)	Q3 2023 (qoq)	Q4 2023 (qoq)	Date of Forecast
What Markets Say					
Bank of America/Merrill Lynch	1.0%	0.5%	-1.0%	-2.0%	17-Mar-23
Capital Economics	1.8%	-1.3%	-2.0%	-0.7%	31-Mar-23
JPMorgan	2.5%	0.8%	0.5%	-0.5%	17-Mar-23
Moody's Economy.com	2.5%	1.0%	1.1%	1.5%	14-Mar-23
Mortgage Bankers Association	-0.1%	-0.6%	1.0%	1.9%	20-Mar-23
National Association of Realtors	0.6%	1.0%	1.8%	1.8%	Mar-23
National Bank of Canada	2.1%	0.3%	0.2%	-0.4%	Mar-23
TD Bank Financial Group	1.0%	0.5%	0.4%	0.7%	15-Mar-23
Wells Fargo/Wachovia	0.7%	1.2%	-0.9%	-2.6%	17-Mar-23
Forecasts average	1.3%	0.4%	0.1%	0.0%	

Source: ECLAC Washington Office, based on market sources.

However, there are wide differences in the forecasts on when growth will start to falter, and by how much. Overall, over half of our sample of forecasts expect a contraction to take place in the fourth quarter of 2023. On one hand, Capital Economics, which expects a recession will start in the second quarter, argues that "acute bank stress will prompt a further tightening in credit conditions" thus leading the economy to fall into recession this year. On the other hand, Moody's baseline assumption—which rests on "deft policymaking by the Fed, further progress on the inflation front, no sudden stop in credit, and a collective psyche that holds up," meaning that consumers will not lose confidence in the economy—is that the U.S. economy will narrowly avert a downturn.²

¹ The Wall Street Journal, "First Republic, SVB, Credit Suisse Show How Higher Interest Rates Caught Up With Banks," by Akane Otani, 18 March 2023.

² Capital Economics, "US Economic Outlook. Banking stress adds to downside risks" by Paul Ashworth, Andrew Hunter and Olivia Cross, 29 March 2023, and Moody's, "Economic Roundup. Collective Psyche Holds Up" analysis by Bernard Yaros, 28 March 2023.

On an annual basis, average market projections point to growth of 1.1% in 2023 and of 0.8% in 2024, inflation at 4.2% in 2023 and 2.4% in 2024, unemployment rate at 3.8% in 2023 and 4.6% in 2024, and the federal funds rate at 5.0% in 2023 and 3.7% in 2024, with all projections made in March 2023 (table 2).

Economic projections released by the Federal Reserve following their rate-setting meeting on 22 March 2023 show officials expect their interest rate increases to slow the economy earlier and push up the unemployment rate in 2023 further than markets project. They show economic growth in 2023 at 0.4% and at 1.2% in 2024. Inflation, based on the Personal Consumption Expenditures Index (PCE), is projected to be 3.3% in 2023 and 2.5% in 2024. The unemployment rate is projected to increase to 4.5% in 2023 and 4.6% in 2024, and the federal funds rate is projected to be at 5.1% in 2023 and 4.3% in 2024, suggesting that Fed officials do not expect to cut interest rates in 2024 as much as markets anticipate.

Potential cascading effects of bank failures and increased market stress have elevated uncertainty about the Federal Reserve's next steps and where the United State economy is headed. While recent growth and job figures point to economic resilience, and inflation continues to slow, the odds of a recession over the next 12 to 18 months have increased with the recent stress in the banking sector and financial markets, while risks of policy moves causing a sharper slowdown have also risen.

Double economic threats have put the United States Congress in a complicated position. In 2008, the U.S. Congress was enveloped by an imminent collapse of the banking system, before lawmakers delivered a bailout. Three years later, it was consumed by a debt limit crisis that led to a series of spending cuts and a first-ever downgrade in the United States' credit rating. This year, both challenges have become intertwined, with unease about the banking system's stability and a stalemate over raising the debt limit intensifying an already elevated level of financial anxiety.³ Facing both challenges simultaneously, Congress could contribute to further economic uncertainty.

³ The New York Times, "Double-Barreled Economic Threat Puts Congress on Edge," by Carl Hulse, 23 March 2023.

Table 2
Annual forecasts for United States economic growth, 2023 and 2024
(Percentage change)

		Real GDP		Inflation		Unemployment		FED Funds Rate		Date of Forecast
		(% change, y/y)		(% change, y/y)		Rate (%)		(%)		
		2023	2024	2023	2024	2023	2024	2023	2024	
A. What Government Agencies Say										
	FED ¹	0.4%	1.2%	3.3%	2.5%	4.5%	4.6%	5.1%	4.3%	Mar-23
	CBO	0.3%	1.8%	4.8%	3.0%	4.7%	4.9%	5.0%	3.6%	Feb-23
	OMB ²	0.4%	2.1%	3.0%	2.3%	4.6%	4.5%	na	na	Nov-22
B. What Markets Say										
	Bank of America/Merrill Lynch	1.0%	-0.1%	4.2%	2.5%	3.7%	4.7%	5.4%	3.6%	17-Mar-23
	Capital Economics	0.7%	0.6%	4.0%	2.3%	3.8%	5.0%	4.1%	2.6%	31-Mar-23
	JPMorgan	1.7%	0.4%	4.2%	2.6%	3.8%	4.9%	5.1%	na	17-Mar-23
	Moody's Economy.com ³	1.9%	1.9%	4.1%	2.4%	3.5%	3.9%	4.9%	4.3%	14-Mar-23
	Mortgage Bankers Association	0.5%	1.9%	3.5%	2.2%	4.2%	4.6%	4.9%	3.6%	20-Mar-23
	National Association of Realtors ³	1.1%	1.6%	5.1%	3.6%	3.6%	4.0%	4.8%	3.8%	Mar-23
	National Bank of Canada	1.4%	-0.4%	3.7%	1.4%	3.8%	5.1%	5.5%	3.8%	Mar-23
	TD Bank Financial Group	1.3%	1.0%	4.7%	2.5%	3.6%	4.5%	5.2%	4.0%	15-Mar-23
	The Economist Intelligence Unit ⁴	0.7%	1.2%	4.0%	2.2%	4.1%	4.3%	5.1%	5.0%	1-Mar-23
	Wells Fargo/Wachovia ³	1.0%	0.3%	4.0%	2.5%	3.9%	5.0%	5.0%	2.9%	17-Mar-23
	Market Average	1.1%	0.8%	4.2%	2.4%	3.8%	4.6%	5.0%	3.7%	
C. What International Organizations Say										
	United Nations DESA (Baseline)	0.4%	1.6%	4.8%	2.5%	4.2%	na	na	na	Jan-23
	World Bank	0.5%	1.6%	na	na	na	na	na	na	Jan-23
	OECD	1.5%	0.9%	3.7%	2.5%	na	na	na	na	Mar-23
	IMF	1.4%	1.0%	na	na	na	na	na	na	Jan-23

Source: ECLAC Washington Office based on official and market sources.

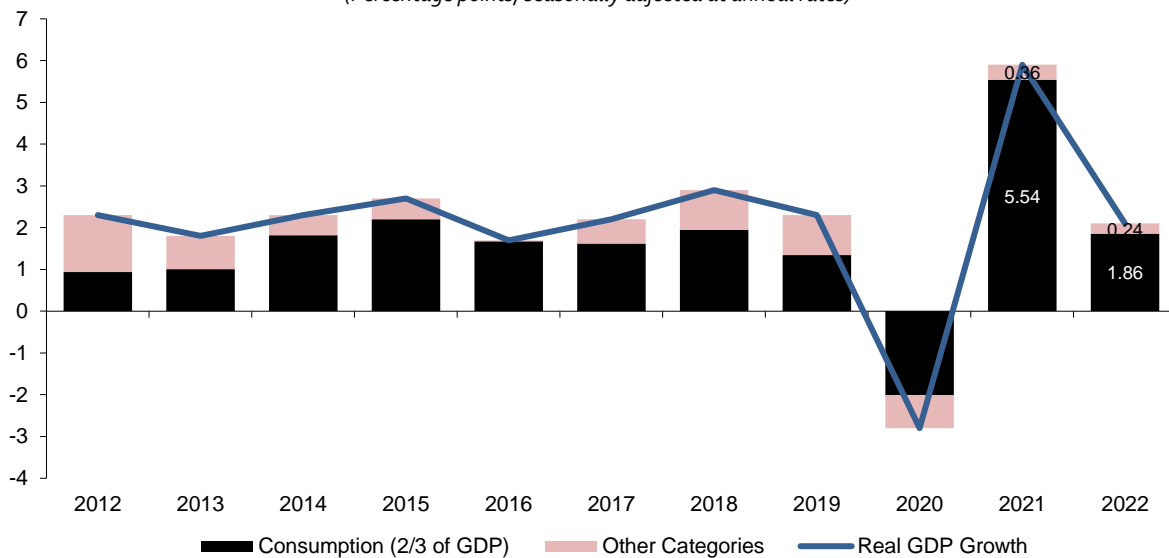
Note: FED: Federal Reserve; CBO: Congressional Budget Office; OMB: Office of Management and Budget (U.S. Administration's forecasts).

¹ Projections of change in real GDP and inflation (measure used is PCE inflation, the FED's preferred measure) are percent changes from the fourth quarter of the previous year to the fourth quarter of the year indicated. ² Projections are for real, chained (2012) dollars GDP, fourth quarter-over-fourth quarter; CPI: fourth quarter-over-fourth quarter; unemployment rate: annual. ³ Moody's, the National Association of Realtors, and Wells Fargo/Wachovia forecast the Fed funds rate as an annual average, not end-period ³ CPI: average; Fed Funds Rate: end-period.

I. Quarterly developments

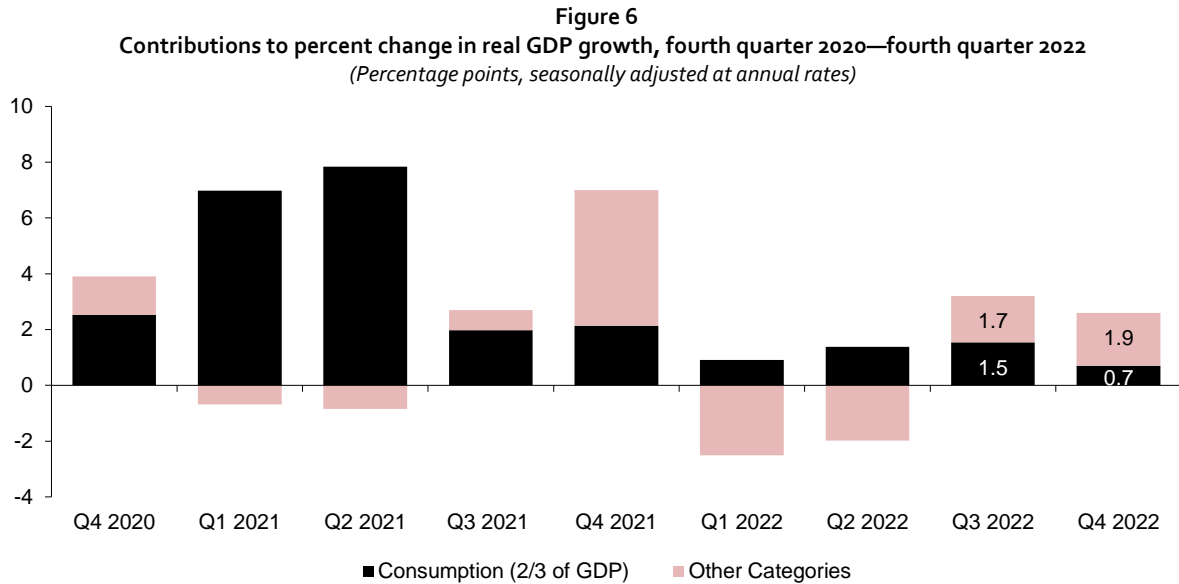
Growth returned in the second half of 2022, following declines in the first half. Annual growth in 2022 was driven by consumer spending, which accounts for about two-thirds of the United States Gross Domestic Product (GDP) (figure 5). The real GDP expansion in 2022 reflected increases in consumer spending, exports, private inventory investment, and nonresidential fixed investment that were partly offset by decreases in residential fixed investment and federal government spending. Imports, which are a subtraction in the calculation of GDP, increased.

Figure 5
Contributions to percent change in real GDP growth, 2012–2022
(Percentage points, seasonally adjusted at annual rates)



Source: ECLAC Washington Office, based on data from the Bureau of Economic Analysis, U.S. Department of Commerce.
 Note: Contributions to growth are measured at seasonally adjusted annual rates.

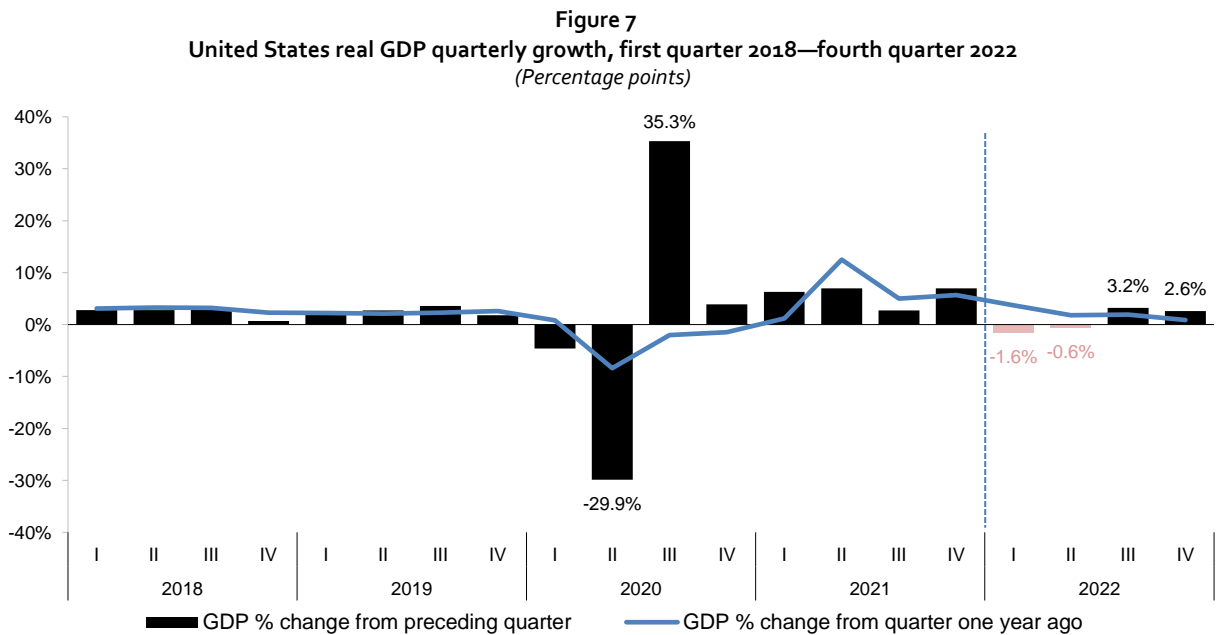
Following growth of 3.2% in the third quarter of 2022, GDP increased by 2.6% in the fourth quarter. Consumer spending contribution fell to 0.7% in the fourth quarter from 1.5% in the third (figure 6).



Source: ECLAC Washington Office, based on data from the Bureau of Economic Analysis, U.S. Department of Commerce.
 Note: Contributions to growth are measured at seasonally adjusted annual rates.

A. Quarterly GDP Growth

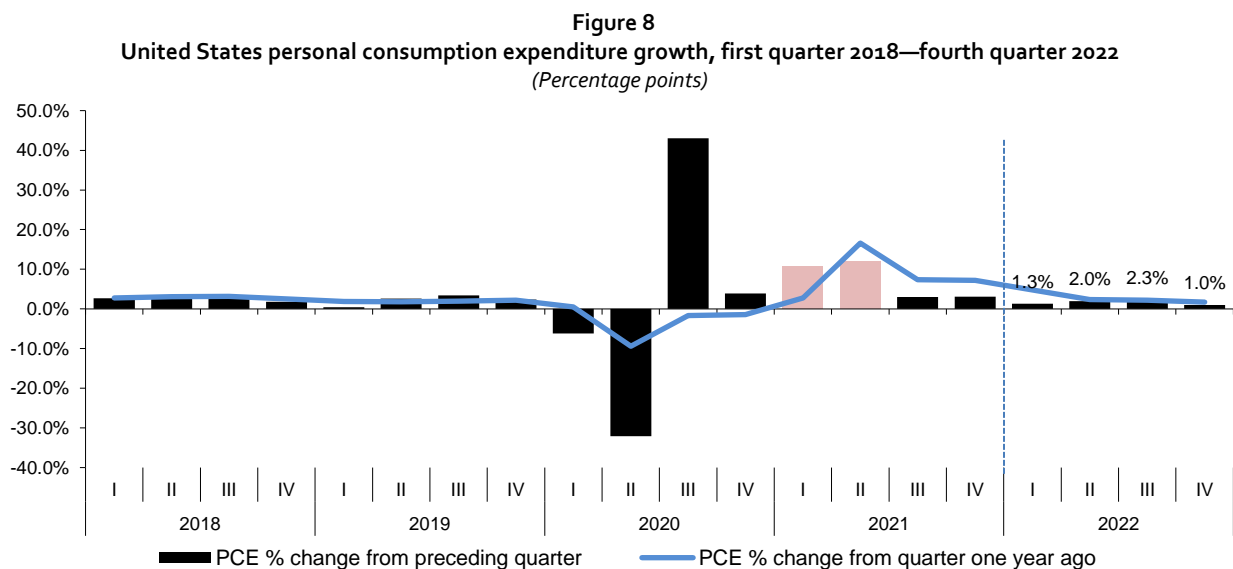
Real gross domestic product (GDP) increased at an annual rate of 2.6% in the fourth quarter of 2022 according to the third estimate released by the Bureau of Economic Analysis on 30 March 2023, the second consecutive quarter of above trend growth. The return to growth in the second half of 2022 followed declines of 1.6% and 0.6% in the first and second quarters, respectively (figure 7).



Source: ECLAC Washington Office, based on data from the Bureau of Economic analysis, U.S. Department of Commerce.

The increase in real GDP in the fourth quarter primarily reflected increases in private inventory investment, consumer spending, nonresidential fixed investment, federal government spending, and state and local government spending that were partly offset by decreases in residential fixed investment and exports. Imports decreased.

Personal consumption expenditure (PCE) increased 1.0% in the fourth quarter of 2022, following an increase of 2.3% in the third quarter (figure 8). It remained an important source of growth in the fourth quarter but contributed more modestly due to last year's weak real income growth, 0.70% versus 1.5% in the third quarter. The contribution to growth came entirely from the services sector, as spending in durable and nondurable goods was nearly flat, with durable goods spending falling slightly and nondurable goods spending rising an offsetting amount.



Source: ECLAC Washington Office, based on data from the Bureau of Economic Analysis, U.S. Department of Commerce.

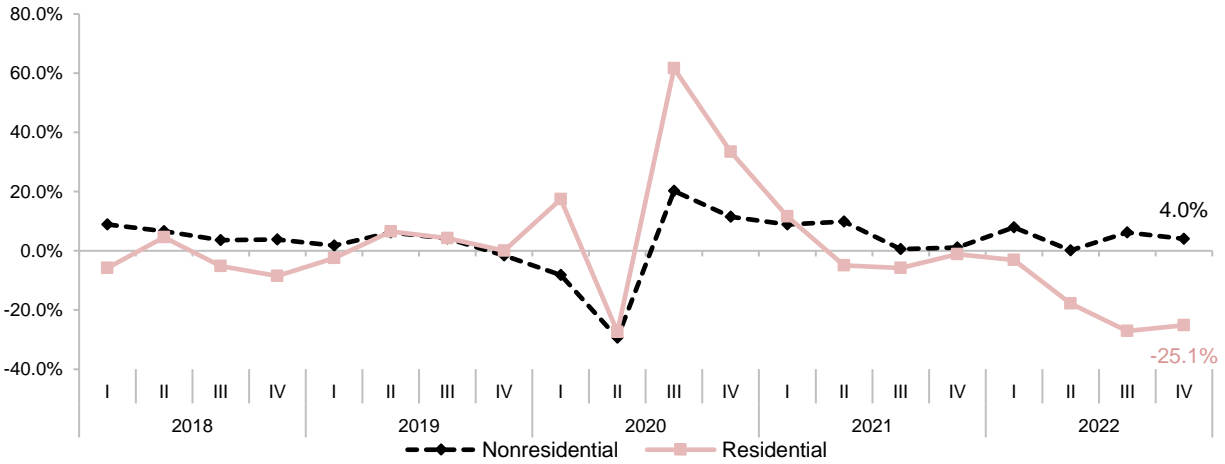
Fixed investment declined 3.8% in the fourth quarter of 2022, its third consecutive quarterly decline. Residential investment fell at an annual rate of 25.1% and non-residential investment grew 4.0% (figure 9). Fixed investment subtracted 0.68% from growth in the fourth quarter, with residential investment subtracting 1.20% (the largest negative contribution to growth in the quarter, as rising mortgage rates weighed heavily on private residential spending) and nonresidential investment adding 0.52%. Inventories added 1.47% to growth as the accumulation of inventories accelerated, the largest contribution to fourth-quarter growth. As a result, gross private domestic investment added 0.79% to fourth quarter growth (-0.68% from fixed investment +1.47% from change in private inventories).

Government spending increased 3.8% in the fourth quarter, following an increase of 3.7% in the third quarter and five quarters of decline. It made a positive contribution to growth in the fourth quarter of 2022. Overall, government spending added 0.65% to growth in the fourth quarter (figure 10).

Exports declined 3.7% in the fourth quarter, led by a decrease of 7.4% in the exports of goods, which was partly offset by an increase in the exports of services (5.0%). Imports declined 5.5%, reflecting declines in both goods and services (5.9% and 3.7%, respectively). Net exports added 0.42% to growth in the quarter.

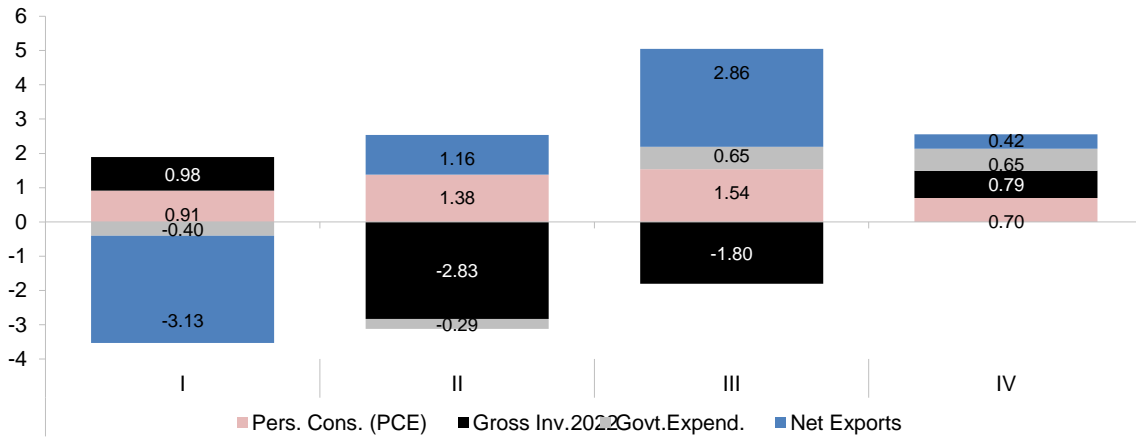
It is possible that the higher interest rates and turmoil in the financial system could push the economy into recession at some point in 2023 or early 2024. The possibility of more cascading effects from recent bank failures, which could affect the banking system's stability, a reacceleration of inflation, given the continued strength of the labor market and the possibility of a spike in energy prices, or a monetary policy misstep, are among possible downward risks to growth this year and next.

Figure 9
United States fixed investment growth, first quarter 2018—fourth quarter 2022
(Percentage points)



Source: ECLAC Washington Office, based on data from the Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 10
Contributions to U.S. real GDP growth, 2022
(Percentage points)



Source: ECLAC Washington Office, based on data from the Bureau of Economic Analysis, U.S. Department of Commerce.

Note: Contributions to growth are measured at seasonally adjusted annual rates.

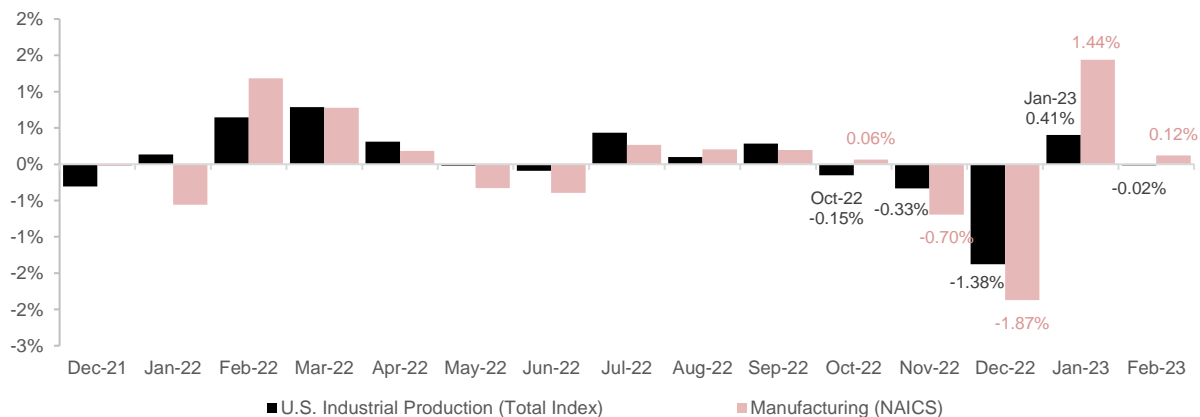
B. Industrial production

United States industrial production increased 0.71% in 2022, a worse performance than in 2021, when industrial production increased 2.89%. Manufacturing output declined 1.01% on an annual basis, after increasing 3.18% in 2021. Industrial production and manufacturing output have improved in early 2023 compared to the last three months of 2022. Total industrial production increased 0.41% in January 2023, following three consecutive months of decline, and was basically flat in February 2023. Manufacturing output rose 1.44% in January 2023 following two consecutive months of decline, and 0.12% in February (figure 11).

Although manufacturing output held its ground in February 2023, it remains below the peak reached in October 2022 (figure 12). The recent resurgence in manufacturing activity in China presents an upside risk to

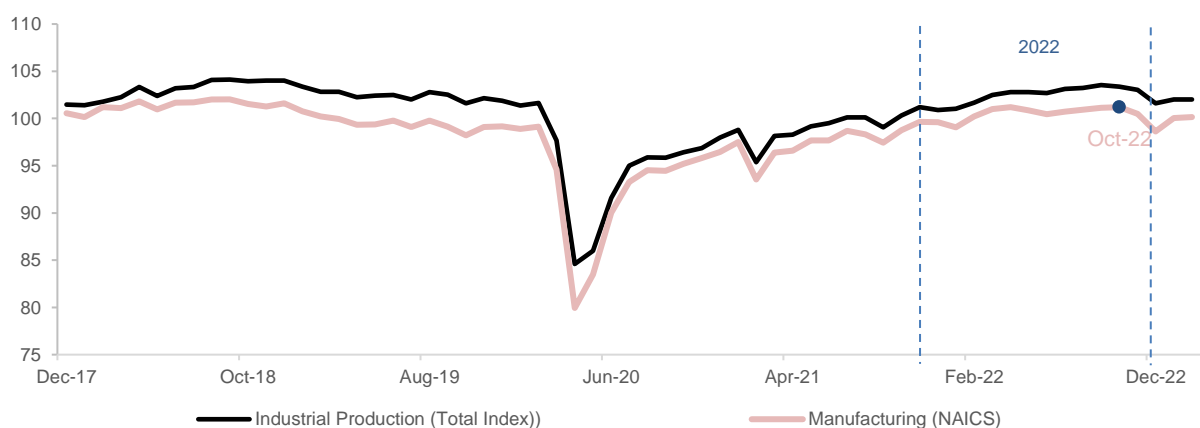
the near-term U.S. manufacturing outlook, but that support could yet be offset by a loss of business confidence and tighter credit conditions resulting from the U.S. banking sector's woes.⁴

Figure 11
United States industrial production and manufacturing output, December 2021—February 2023
(Index 2017=100, Monthly, Seasonally Adjusted; Monthly Percent Change;)



Source: ECLAC Washington Office, based on data from the U.S. Federal Reserve and the Federal Reserve of St. Louis (FRED).

Figure 12
United States industrial production and manufacturing output, December 2017—February 2023
(Index 2017=100, Monthly, Seasonally Adjusted)



Source: ECLAC Washington Office, based on data from the U.S. Federal Reserve and the Federal Reserve of St. Louis (FRED).

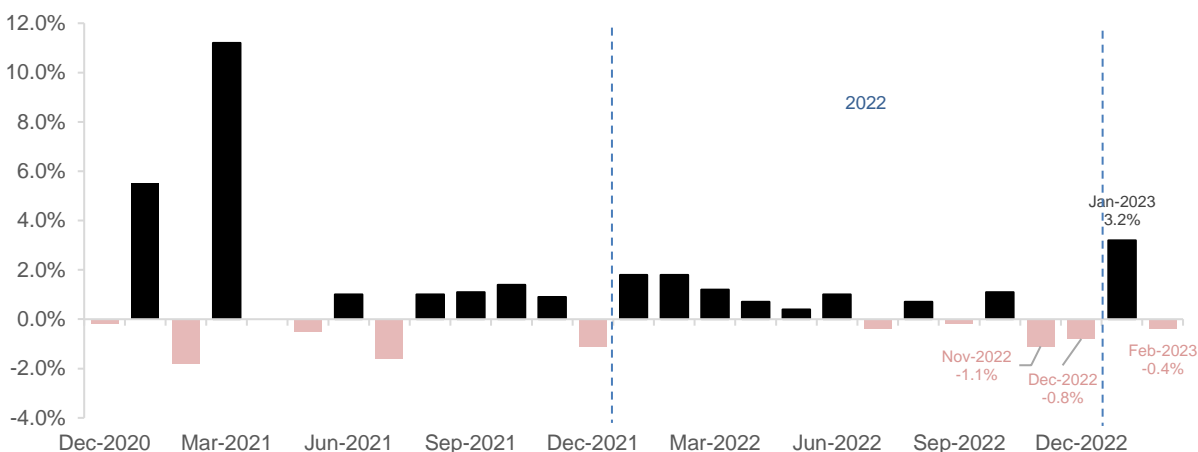
The March Institute of Supply Management (ISM) Manufacturing Index, which measures the breadth of growth in manufacturing, suggests that domestic weakness is offsetting the boost from China's reopening. Contracting for the fifth consecutive month, the index fell from 47.7 in February 2023 to 46.3 in March, its lowest reading since May 2020. On a positive note, the prices paid index fell back into contractionary territory after turning positive in February, suggesting that consumer price inflation may moderate further. In addition, new orders and employment both contracted more sharply, and while production improved slightly, it also remained below its neutral threshold.

⁴ U.S. industrial production expanded 0.4% from February to March 2023. The March figure was released on 14 April 2023, after the cutoff date for this report. Revisions to both January and February's figures were positive. Industrial production is now shown to have grown 0.9% in January (previously 0.3%) and 0.2% in February (previously flat). Manufacturing output fell 0.5% in March, but February's figure was revised upward from 0.1% to 0.6%. Capacity utilization ticked up from 79.6% in February to 79.8% in March.

C. Retail sales

Retail sales, a measure of purchases at stores, restaurants and online, ended on a weak note in 2022, falling in November and December (the critical holiday season) on a seasonally adjusted basis, before a strong gain in January 2023. Consumers retreated in February 2023, however, with retail sale falling 0.4% on a seasonally adjusted basis from a month earlier, according to the Commerce Department. The fall only partly reversed the 3.2% surge in January, suggesting real consumption growth will be strong in the first quarter (figure 13). The mild weather in January may have contributed to the resilience of spending in the first two months of 2023.⁵

Figure 13
United States total retail sales, December 2020—February 2023
(Seasonally adjusted, Month to month percentage change)



Source: ECLAC Washington Office, based on data from Advance Monthly Sales for Retail and Food Services, U.S. Census Bureau.

The February retail sales figure was weighed down by a 1.8% drop in auto sales as well as declines at restaurants and stores selling furniture and clothing. Excluding autos, sales slipped 0.1% from January, according to the Commerce Department. Sales at furniture stores fell 2.5%, while business at restaurants declined 2.2%. Sales at department stores slid 4%. But consumers spent more online and at electronics stores, health and beauty stores and food retailers, according to the report.

In 2022, retail sales advanced 6.2%, slightly slower than the 6.5% consumer inflation as measured by the Consumer Price Index (CPI). From February 2022 to February 2023, retail sales advanced 5.4%, still slower than 6% consumer inflation. Consumers have remained relatively resilient, getting a boost from a strong job market, but they are grappling with still high consumer prices.

The U.S. Conference Board Consumer Confidence unexpectedly improved in March 2023 (to 104.2 from 103.4 in February), despite recent turmoil in the banking system. The cutoff for the Consumer Confidence Survey was 20 March, which came 10 days after the failure of Silicon Valley Bank. The increase in the Consumer Confidence Index, which partly reversed February's decline, was driven by consumers' more sanguine outlook for short-term income, business and labor market conditions.⁶ However, further tightening in credit conditions due to the recent bank failures, alongside the lagged impact of the previous interest rate increases by the Federal Reserve, could weigh on consumption growth going forward.

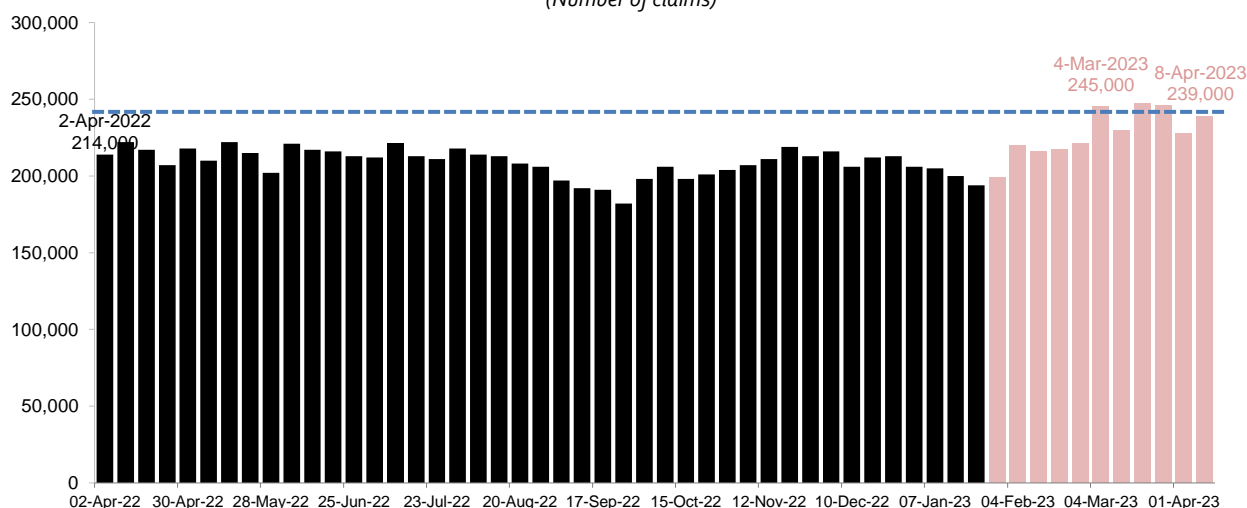
⁵ Retail sales fell again in March 2023 (-1.0%), the fourth month out of the last five in which they have fallen. Retail sales continue to struggle as inflation weighs on consumer finances and spending shifts back toward services. The March figure was released on 14 April 2023, after the cutoff date for this report.

⁶ According to Moody's, "Economic Roundup. Collective Psyche Holds Up" by Bernard Yaros, 28 March 2023, this more sanguine outlook suggests that consumers' confidence in the U.S. economy is holding up.

D. Labor market

The United States labor market remains resilient despite the recent turmoil in the banking system and a string of major job cut announcements, the latest being Amazon’s announcement on 20 March 2023 that it will cut an additional 9,000 employees. Recently announced layoffs have been heavily concentrated on the technology sector, which historically has accounted for a small fraction of announced layoffs. There were 239,000 initial claims for unemployment insurance in the week ended on 08 April 2023, with claims now at or near 240,000 since the beginning of March, a marked increase from the low levels reported during the last year, but still low by historic standards (figures 14).⁷

Figure 14
United States initial unemployment claims filed weekly, April 2022—April 2023
(Number of claims)



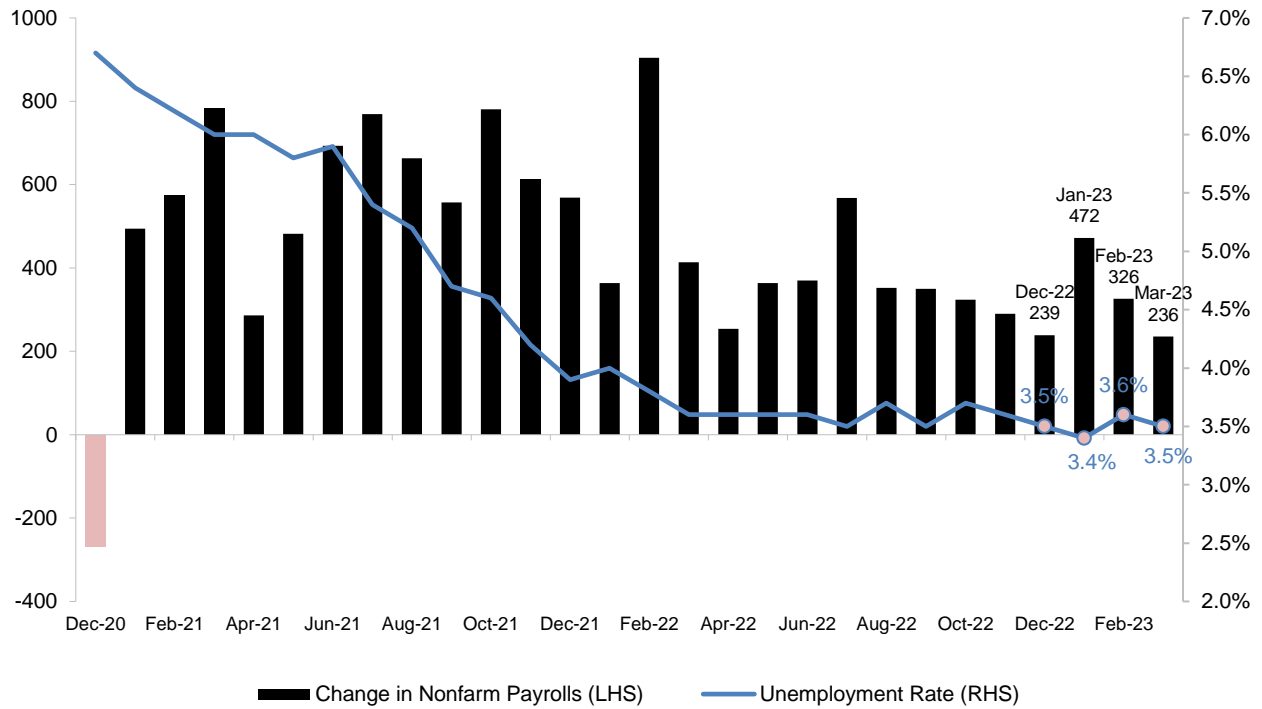
Source: ECLAC Washington, based on data from the Department of Labor unemployment insurance weekly claims report and the Federal Reserve of St. Louis (FRED).

Hiring has been strong in 2023 so far. After adding 4.8 million non-farm payroll jobs in 2022 and averaging 399,000 new jobs per month, the U.S. economy added over one million jobs in the first quarter of 2023 on a seasonally adjusted basis, averaging 345,000 jobs per month. Total nonfarm payroll employment rose by 236,000 in March 2023, the U.S. Bureau of Labor Statistics reported on 7 April 2023. Employment continued to trend up in leisure and hospitality, government, professional and business services, and health care. March 2023 was the 27th consecutive monthly gain, even as policymakers take significant steps to cool the economy and ease inflation, but employment creation is trending lower (figure 15). The average gain for the past three months of 345,000 is sharply lower than it was in the first three months of 2022—when the average was 561,000.

The unemployment rate, which was at 3.5% at the end of 2022, returned to this level in March 2023, following a decline to 3.4% in January 2023—the lowest since 1969—and an increase to 3.6% in February. The March decline was a result of both employment and the labor force growing strongly. According to the household survey in March, total civilian labor force grew by 480,000 from February to March, driving the labor force participation rate up to 62.6% in March from 62.5% in February, helping to take pressure off wage growth. An increase in the number of people looking for jobs is the least painful way to contribute to rebalance the U.S. labor market and alleviate upward pressure on wages, with less job losses. The participation rate, however, is still well below its pre-pandemic level (figure 16).

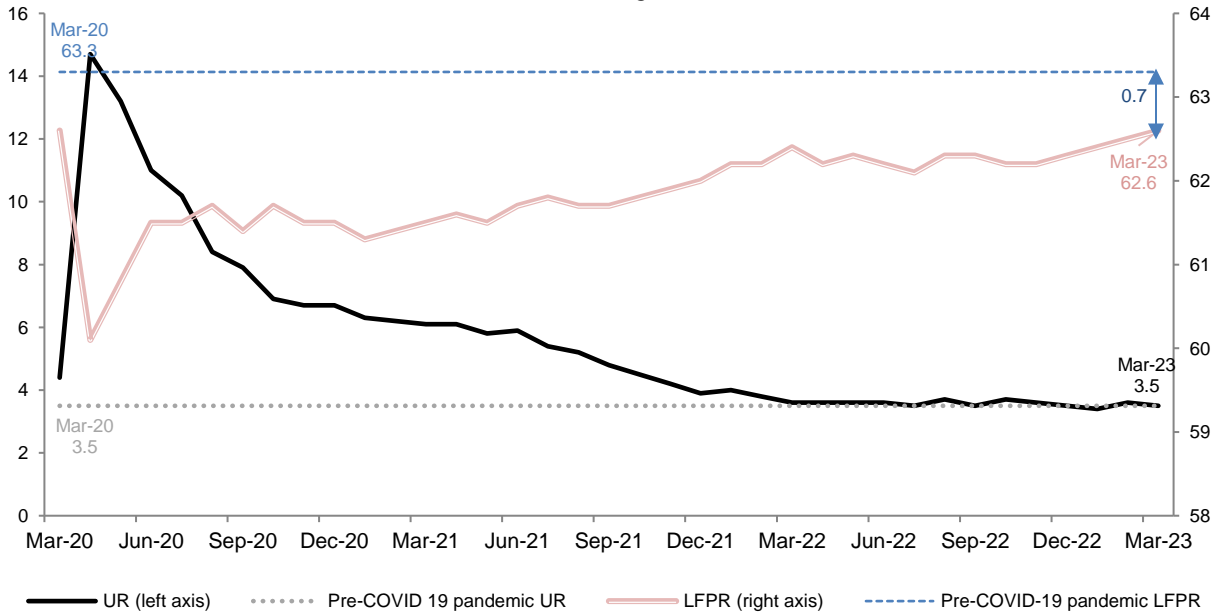
⁷ For historical reference, weekly unemployment claims were at 212,000 in the week ended on 7 March 2020, right before the pandemic, and increased to a peak of 6,137,000 on 4 April 2020. From this peak it declined to a low of 182,000 in the week ended on 24 September 2022. The record low (162,000) was reached in November of 1968.

Figure 15
United States monthly job creation and unemployment rate, December 2020—March 2023
(Average monthly job growth in thousands (left axis); Percentage (right axis))



Source: ECLAC Washington Office, based on data from the U.S. Bureau of Labor Statistics.

Figure 16
United States labor force participation share, February 2020—February 2023
(Percentage)

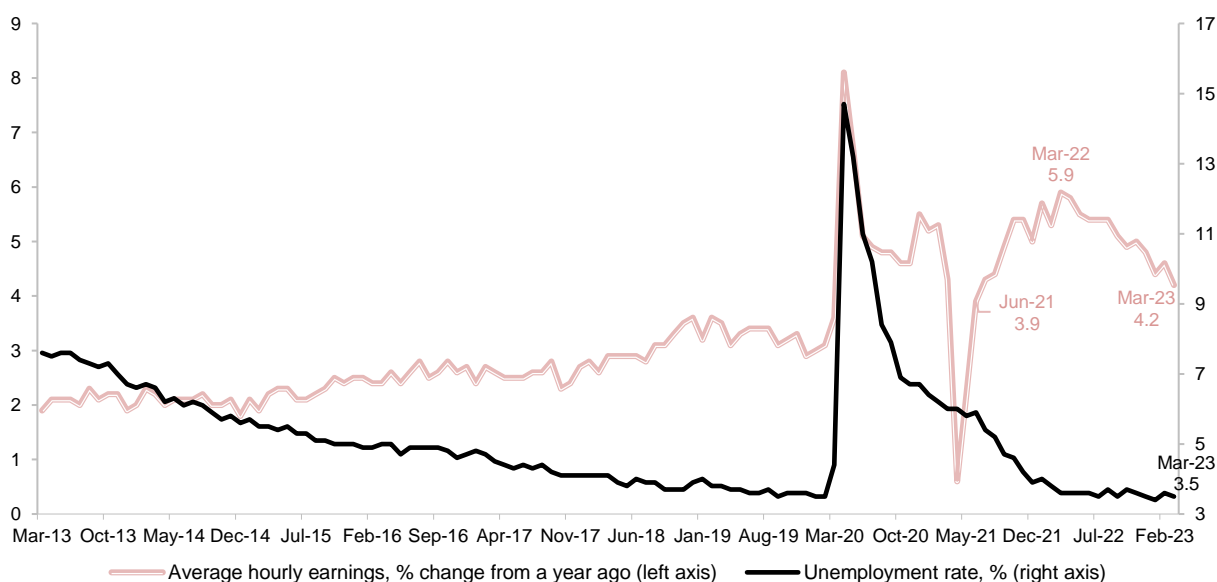


Source: ECLAC Washington Office, based on data from the U.S. Bureau of Labor Statistics. UR: unemployment rate; LFPR: labor force participation rate.

According to the Bureau of Labor Statistics, despite gradual recovery, the labor force participation rate (LFPR) in March 2023 remained almost a percentage point lower than that of March 2020. Caregiving responsibilities have prevented some from returning to the workforce. In the Census Household Pulse Survey with data as of 17 January 2023, a combined 7% of respondents not working reported caregiving as the reason. This was broken down further: 5% were looking after children and 2% elderly relatives. Moreover, according to the Consumer Price Index (CPI), daycare and preschool costs have increased by more than 10% since the start of the pandemic. This is an even bigger burden for lower-income households, which could partly explain the larger labor force exits at the lower end of the income spectrum.⁸

Federal Reserve Chair Jerome Powell has pointed to the imbalance between job openings and available workers as a key driver of inflation, as strong labor demand can drive up wages. The labor-force participation rate has edged up in recent months, as seen above, and wage growth has slowed, both signs of a looser labor market. Average hourly earnings growth in March 2023 (0.3%) came in line with consensus expectations. Over the past year, hourly earnings were up 4.2%, down from a peak of 5.9% in March 2022 and the lowest increase since June 2021 (figure 17).

Figure 17
United States average hourly earnings and unemployment rate, March 2013—March 2023
(Percentage)



Source: ECLAC Washington Office, based on data from the U.S. Bureau of Labor Statistics.

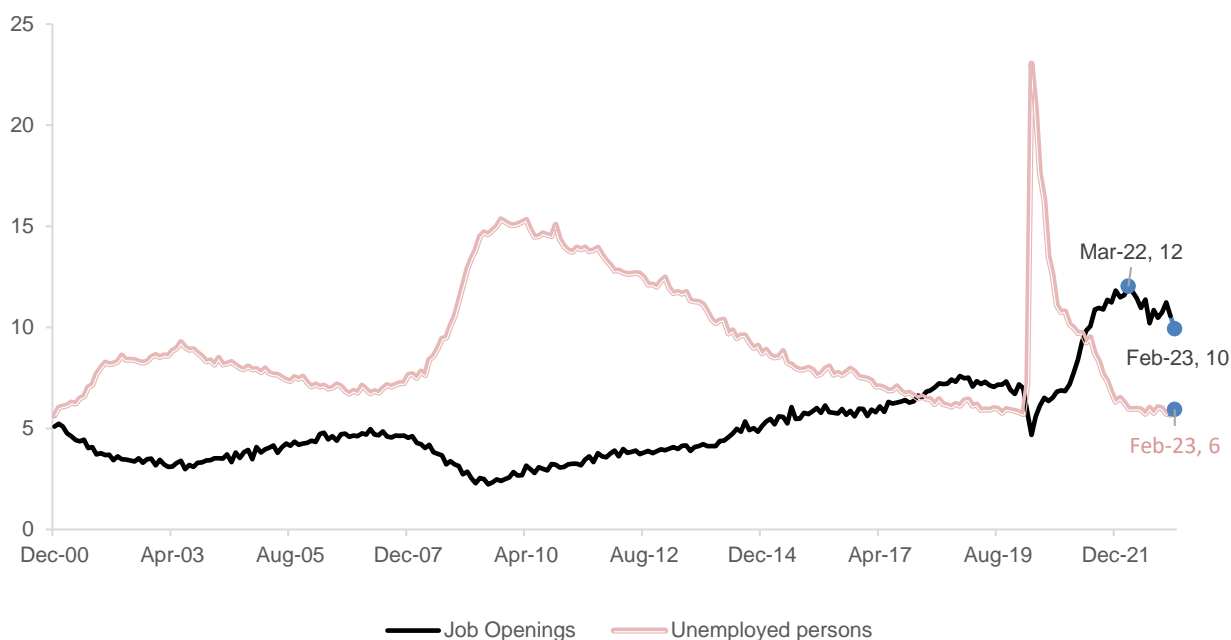
Despite the resilience in wages and solid job gains so far this year, labor market conditions are easing gradually. Job openings fell below ten million in February 2023 for the first time in nearly two years, in a sign that the Federal Reserve's efforts to slow the labor market may be having some impact.

According to the latest Job Openings and Labor Turnover Survey (JOLTS) released on 4 April 2023, job openings in February 2023 declined to 9.9 million, the first-time vacancies fell below ten million since May 2021, from 10.6 million in January and 11.2 million in December 2022, and from a record twelve million reached in March 2022. Job openings in February still far outnumbered the 5.9 million unemployed people seeking work, indicating the labor market remained tight (figure 18). Prior to the February data, job openings had been outnumbering available workers by nearly 2 to 1. The latest figures bring that ratio down to less than 1.7 to 1.

⁸ Bank of America Institute, "Understanding the missing millions" 2 February 2023 <online> <https://business.bofa.com/content/dam/flagship/bank-of-america-institute/economic-insights/understanding-the-missing-millions-february-2023.pdf>

In the first two months of 2023, the number of job openings has fallen 1.3 million, a necessary development if wage growth is to slow toward the 3.5% rate the Federal Reserve deems compatible with the 2% inflation target. However, the quits rate, which is a more reliable indicator of upward wage pressure than openings, edged up in February to 2.6% from 2.5% in January. People quit their jobs when they find better-paying work, and according to the Atlanta Federal Reserve wage tracker, job switchers have seen much faster pay increases than employees that have stayed put. Despite that, the release of the February job openings number had an immediate impact on sentiment globally, rekindling recession fears. In the aftermath of the release, Treasury notes gained, and equities pulled back as a result.

Figure 18
United States job openings vs number of unemployment persons: December 2000—February 2023
(Millions of openings and persons)



Source: ECLAC Washington Office, based on data from FRED Graph Observations, Federal Reserve Bank of St. Louis, Job Openings: Total Nonfarm, Level in Thousands, Monthly, Seasonally Adjusted and Unemployment Level, Thousands of Persons, Monthly, Seasonally Adjusted.

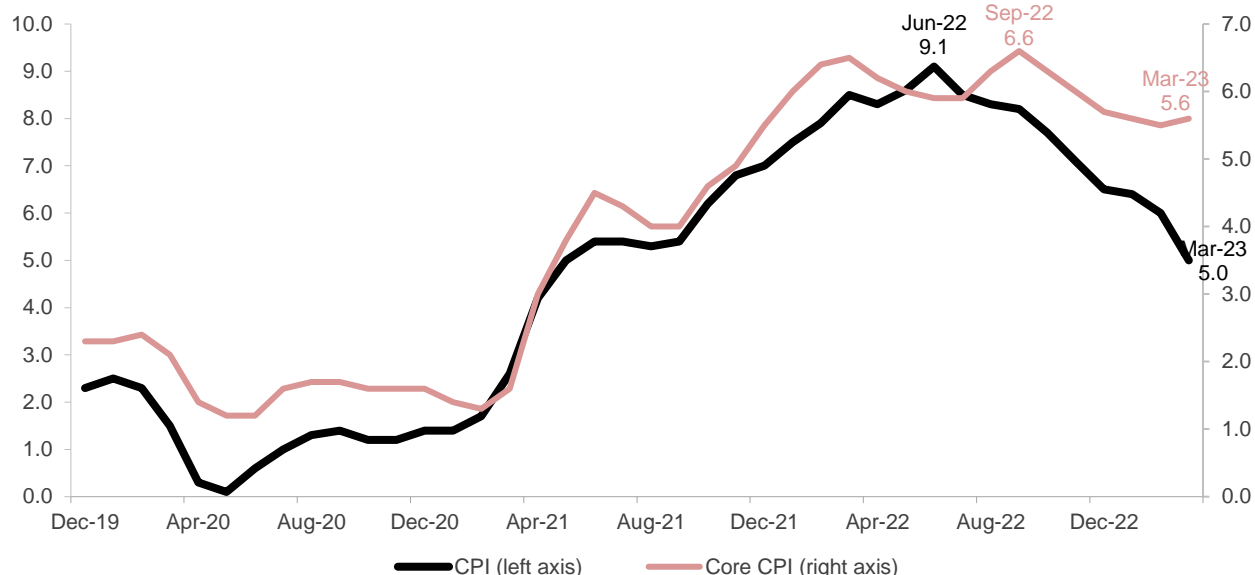
E. Inflation

Building on a trend of moderating price increases since inflation reached a peak of 9.1% in June 2022, the Consumer Price Index for All Urban Consumers (CPI-U)—which measures the costs of everyday goods and services from food to dental care—advanced 5.0% in March 2023 at an annualized rate, down from 6.0% in February. That was the lowest rate since May 2021, and the ninth straight month of rate declines (figure 19).

Prices excluding food and energy, the core CPI, rose 5.5% at an annualized rate in February 2023, down from a peak of 6.6% in September 2022 and the smallest 12-month increase since the period ending September 2021. According to the U.S. Bureau of Labor Statistics, the energy index increased 5.2% for the 12 months ending in February 2023, and the food index increased 9.5%.

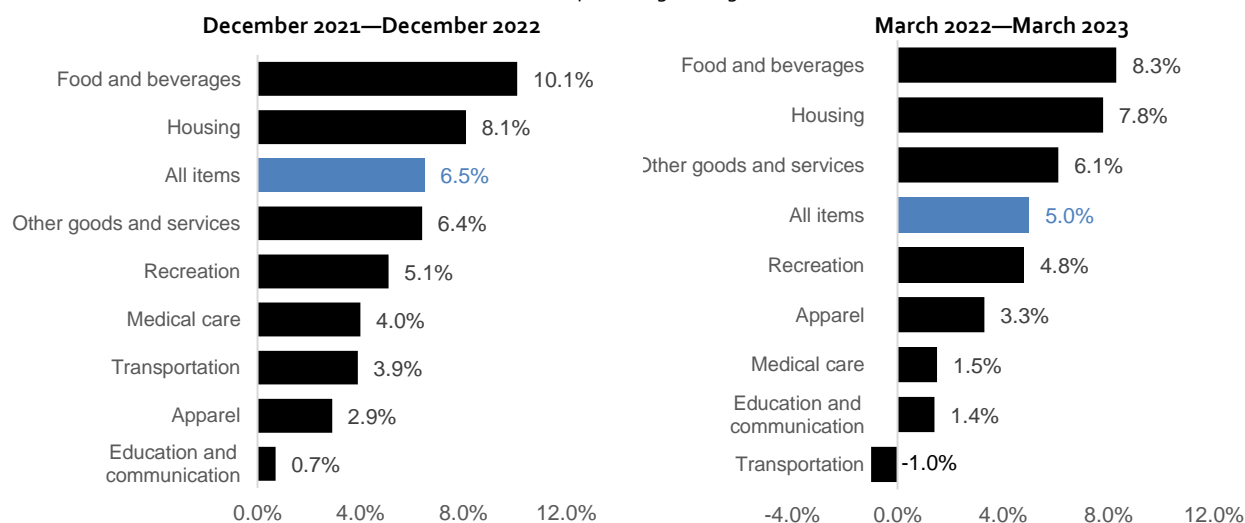
The CPI measures more than two hundred categories of items arranged into eight major groups: food and beverages, housing, apparel, transportation, medical care, recreation, education and communication, and other goods and services. The steepest increases in prices in the twelve months ending in February 2023 were for food and beverages and housing (figure 20).

Figure 19
United States domestic prices: monthly evolution, December 2019—March 2023
(CPI-U unadjusted 12 months percent change)



Source: ECLAC Washington Office, based on data from the U.S. Bureau of Labor Statistics

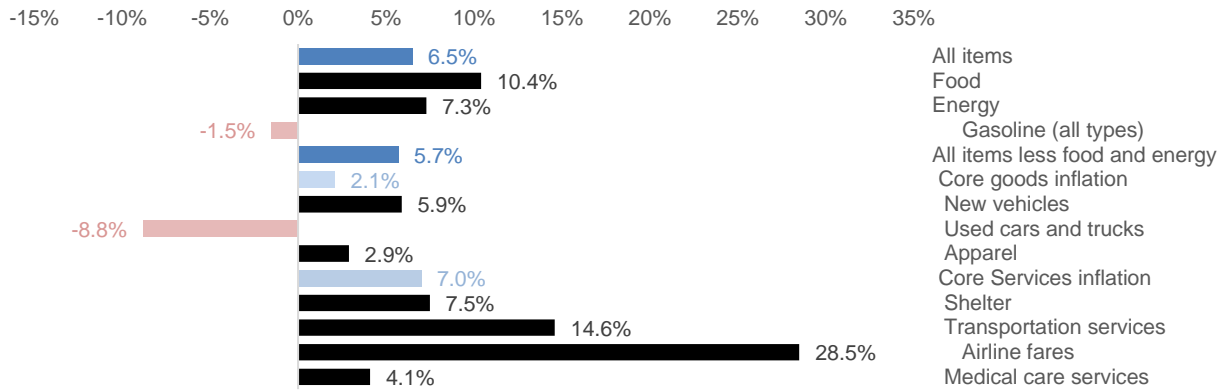
Figure 20
United States CPI by major groups of consumer expenditures
(12-month percentage change)



Source: ECLAC Washington Office, based on data from the United States Bureau of Labor Statistics. Consumer Price Index – March 2023, tables 1 and 3. Housing includes shelter, fuel and other utilities, and household furnishings and operation. Shelter, which includes rents, increase 8.2% in the period.

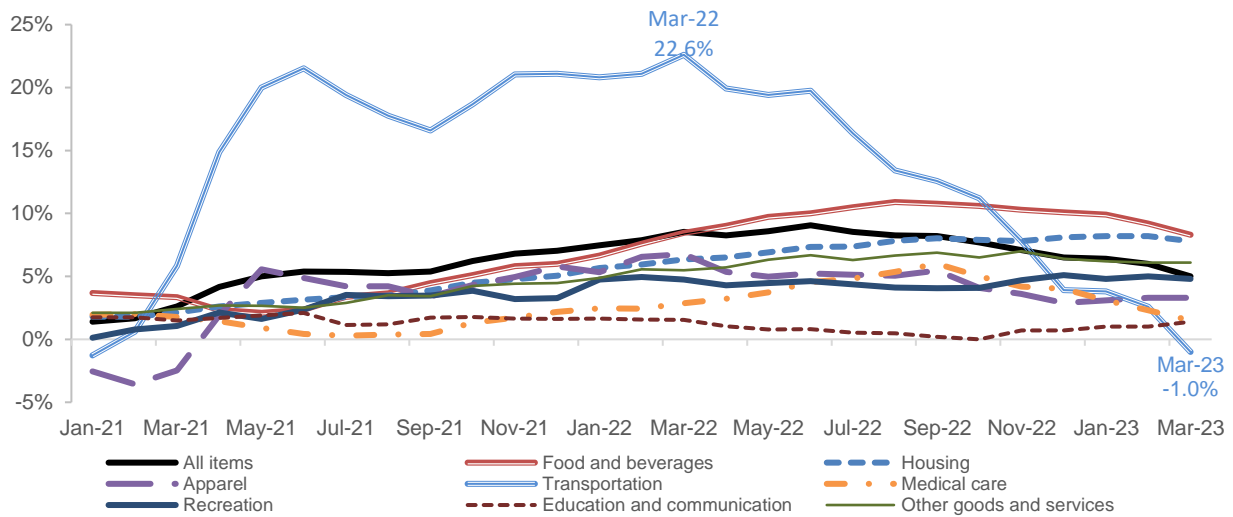
Food and energy increased at 10.4% and 7.3% annual rates in 2022, respectively, with gasoline prices declining 1.5%. Core inflation (less food and energy) ended the year at 5.7%, with core goods inflation (represented by the BLS category “commodities less food and energy commodities”) at 2.1% and core services inflation (“services less energy services”) at 7.0%. Transportation services and shelter were the largest contributors to the increase in prices in 2022 (figure 21). Transportation prices have been on a declining trend since March 2022 and fell by 1.0% in March 2023 (figure 22).

Figure 21
United States CPI variation in select categories, December 2021—December 2022
(12-month percentage change)



Source: ECLAC Washington Office, based on data from the United States Bureau of Labor Statistics.

Figure 22
United States Consumer Price Index by major groups, January 2021—March 2023
(12-month percentage change)

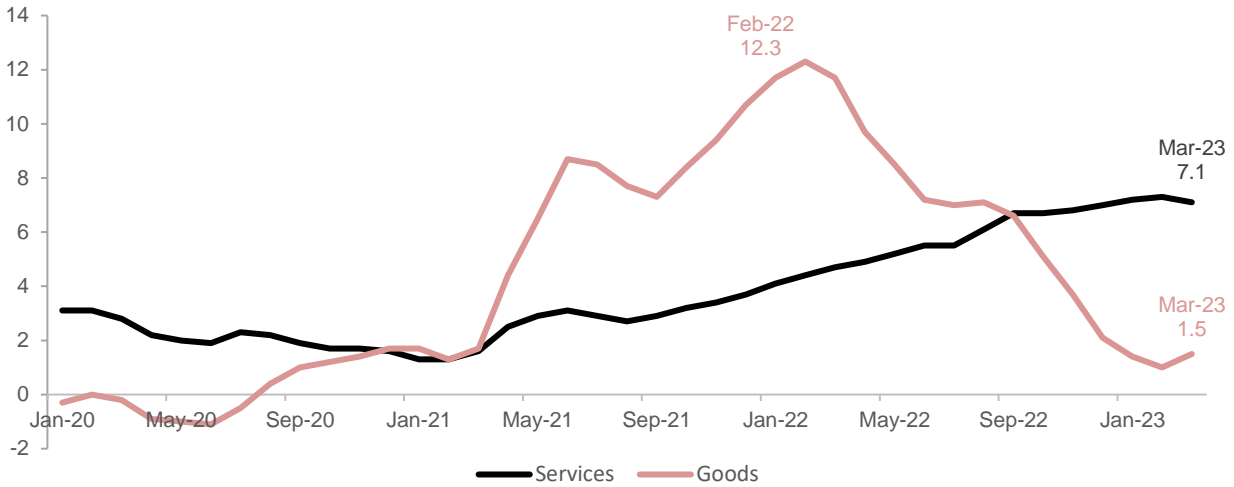


Source: ECLAC Washington Office, based on data from the United States Bureau of Labor Statistics.

Inflation started in goods affected by supply chain issues, but as supply chain pressures eased, the prices of services rose. Stress in U.S. supply chains eased last year—as shipping costs and commodity prices fell, inventories grew, and consumer spending shifted away from goods towards services—and the appreciation of the U.S. dollar, which make goods exports more expensive, weighed on growth in core goods prices. The easing of COVID restrictions in China against a backdrop of weaker global demand has allowed supply conditions to improve further. For the twelve months ended in March 2023, while core goods prices rose 1.5%, down from a peak of 12.3% in February 2022, core service prices were up 7.1% according to data from the Bureau of Labor Statistics (figure 23).

As the economy overcomes supply chain disruptions, and the aggressive tightening in monetary policy begins to work towards reducing excess demand, inflation is gradually decelerating. The turmoil in the banking sector has complicated the path for monetary policy, however, as the Federal Reserve has to balance the still high inflation with maintaining financial stability. The March uptick in core inflation is expected to keep the pressure on the Federal Reserve to continue prioritizing taming inflation, and the Fed could push ahead with another rate rise in May, its next rate-setting meeting.

Figure 23
United States core consumer prices, January 2020 – March 2023
(12-month percentage change)

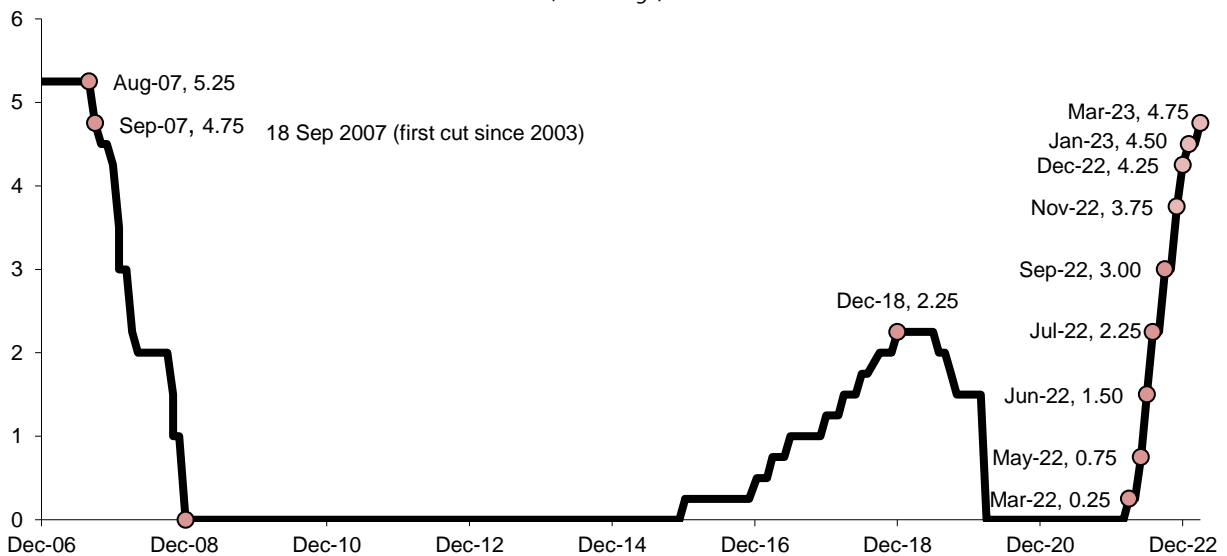


Source: ECLAC Washington Office, based on data from the United States Bureau of Labor Statistics. Goods: Commodities Less Food and Energy Commodities in U.S. City Average, Services: Services Less Energy Services in U.S. City Average. Not Seasonally Adjusted.

F. Monetary policy

In March 2023, the Federal Reserve increased its short-term benchmark interest rate for the ninth consecutive time (figure 24). The Federal Open Market Committee (FOMC) voted unanimously to raise the federal funds rate by 0.25% to the 4.75%-5.00% range. With this decision, the FOMC demonstrated its commitment to tame inflation. Policymakers expect that stress in the banking sector, especially in regional banks, will lead to tighter financial conditions, limiting the need to hike much further. The quantitative tightening has continued at a monthly pace of US\$ 95 billion.

Figure 24
U.S. federal funds target rate, December 2006—March 2023
(Percentage)



Source: ECLAC Washington Office, based on data from the U.S. Federal Reserve. Rates in the chart are the bottom limit of the target range for the federal funds rate.

The median rate projection puts the policy rate as high as 5.1% at end-2023, at 4.3% (a slight increase from the 4.1% forecast in December 2022) at end-2024, and 3.25% at end-2025, suggesting at least one more interest rate hike this year and rate cuts in 2024 and 2025. All but one of the meeting's participants are expecting to raise interest rates at least one more time in 2023, and several see rates going even higher, implying that policymakers will need to see more tangible evidence that inflation is heading lower before pausing. This was reiterated by the Federal Reserve's Chair at the press conference following the meeting.

According to Chairman Powell, the core personal consumption expenditure (PCE) index (at 4.6% in February 2023), the central bank's preferred measure of inflation, can be decomposed into three categories: core goods, housing, and core services excluding housing. Of these three categories, the third is the largest, accounting for more than half of the core PCE deflator. According to him, a disinflationary process has started, and you can see it in goods prices. Regarding housing, although prices are expected to still go up a little further, it is anticipated that they soon should come down. However, core non-housing services has shown no indication that a disinflationary process will start at any time soon. Without a decisive move lower in inflation, the FOMC may deliver another 0.25% rate increase at its meeting in May.

Rising interest rates have already contributed to curb business and household credit demand. The latest Federal Reserve's Senior Loan Officer survey shows that higher rates have significantly suppressed demand for household credit including mortgages, credit cards and auto loans, as well as demand for commercial and industrial (C&I) loans to large, middle-market, and small firms over the fourth quarter.⁹

The fastest pace of monetary policy tightening since the early 1980s—from March 2022 to March 2023, the federal funds rate rose 4.75 percentage points—has contributed to a spate of bank failures. The regional banks that failed had idiosyncratic problems yet were hurt by systemic pressures. The sudden collapse of Silicon Valley Bank (SVB) in March 2023 was partly driven by assets that lost value when interest rates rose from near zero. Following the collapse of SVB, Signature Bank also collapsed.

The Federal Reserve responded quickly to the bank failures, joining other regulators in **lifting the US\$ 250,000 deposit insurance limit per account for customers of those banks** and creating a lender of last resort facility: the **Bank Term Funding Program (BTFP)**. The facility was created to lend to other banks that had big unrealized losses on their holdings of government bonds, which lost value when interest rates increased and were, therefore, at risk of large-scale withdrawals of deposits. If able to hold on to the securities until maturity, no losses would be realized. In an opinion commentary, Kupiec and Pollock said the Federal Reserve's own asset-liability mismatch has generated cash-operating losses amounting to US\$ 42 billion since September 2022, the first time it has had losses.¹⁰

Lee and Wessel in a Brookings post explain the Federal Reserve's actions following the SVB and Signature bank failures,¹¹ including how the Federal Reserve has exercised its lender of last resort function through the newly created lender of last resort facility, the BTFP, and its traditional discount window, as well as how it moved to shore up dollar access across the global financial system:

- The **BTFP** allows banks to exchange assets such as U.S. Treasury notes for cash at their full-face amount, regardless of the current market value. These loans are up for one year at an interest rate equal to the one-year overnight index swap (OIS) rate on overnight loans, plus 0.10 percentage points. This rate varies daily. As of 3 April 2023, the BTFP rate was 4.83%. As of 29 March 2023, banks borrowed US\$ 64.4 billion through the Bank Term Funding Program, up from US\$ 53.7 billion the week before. The Treasury has earmarked US\$ 25 billion to backstop the BTFP, but the Fed said it does not anticipate it will have to draw on that.

⁹ Federal Reserve, "The January 2023 Senior Loan Officer Opinion Survey on Bank Lending Practices", 6 February 2023, <online> <https://www.federalreserve.gov/data/sloos/sloos-202301.htm>

¹⁰ Paul H. Kupiec and Alex J. Pollock, "For the First time, the Fed Is Losing Money" Opinion/Commentary, *The Wall Street Journal*, 26 March 2023.

¹¹ James Lee and David Wessel, "What did the Fed do after Silicon Valley Bank and Signature Bank failed?" Brookings, posted on 22 March 2023 and updated on 3 April 2023.

- The **discount window** is a permanent facility that lends cash to banks. Discount window lending jumped quickly following the bank failures, soaring from US\$ 4.6 billion on 9 March to US\$ 152.9 billion on 15 March and falling to US\$ 88.2 billion on 29 March. The decrease was largely offset by increased borrowing through the BTFP. The discount rate, the interest that banks pay on these loans, is set by the Federal Reserve Board. As of 3 April, it was 5.0%. In addition, the Fed lent US\$ 180.1 billion to the banks the FDIC established to take over SVB and Signature Bank.
- **Swap lines** are a series of agreements with foreign central banks under which the Fed swaps U.S. dollars for foreign currency, as many banks overseas borrow and lend in U.S. dollars. At times of stress, foreign banks often face demand for dollars they are not always able to meet. The swap lines were created during the 2008 financial crisis and totaled more than US\$ 580 billion—more than a quarter of all the Fed’s assets—at the program’s peak. Until March 2023, the Fed conducted these swaps once a week. On 19 March 2023, the Federal Reserve together with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank and the Swiss National Bank announced they would begin daily swaps at least through the end of April to guarantee the readily availability of U.S. dollars across the global financial system and shore up dollar access. As of 22 March, the Fed had US\$ 587 million in these swaps outstanding.

According to the Federal Reserve’s weekly balance sheet publication (H.4.1) on 16 March, outstanding emergency loans stood at US\$ 318 billion as of 15 March, up from US\$ 15 billion a week earlier. This revealed that the liquidity crunch following the bank failures was much more severe than at the start of the pandemic, when emergency loans peaked at US\$ 130 billion in early April 2020, and not far off the financial crisis peak of US\$ 437.5 billion in mid-October 2008.¹² The H.4.1 data for the week through 29 March showed reductions in borrowing across the Fed’s facilities, indicating a stabilization of funding stress.

As banks move towards tightening lending standards as a result of the recent bank failures and financial volatility, both business and consumer credit demand are anticipated to diminish further, especially in the most rate-sensitive sectors. Future FOMC interest rate decisions will thus depend not only on the most recent macroeconomic data, but also on how much additional tightening will take place through the bank lending channel and the broader tightening in financial conditions, thus the policy rate path remains highly uncertain.

G. Fiscal policy

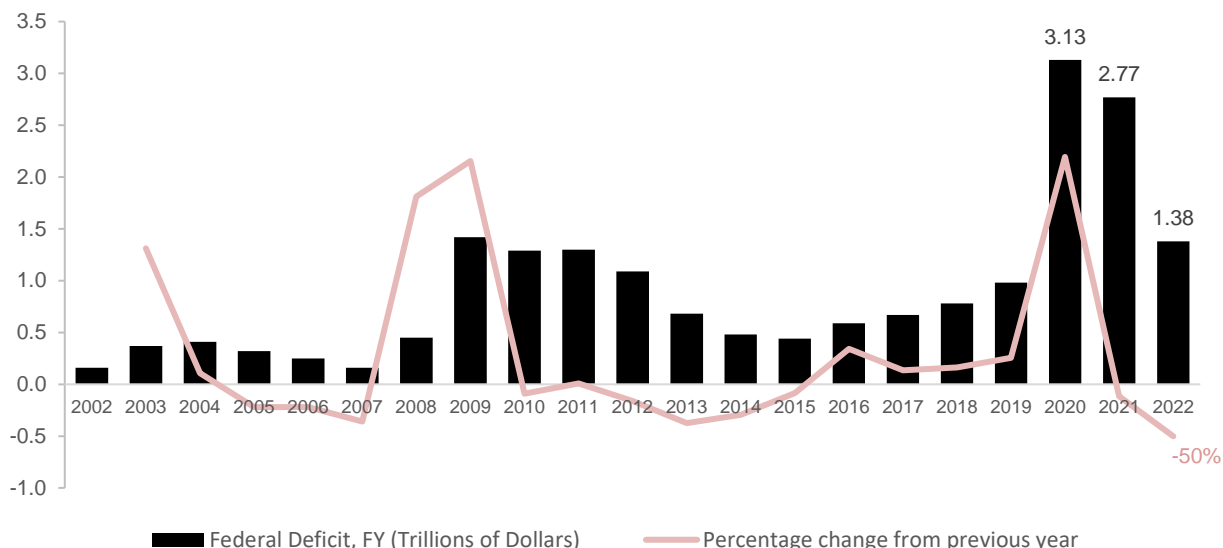
The United States government posted a record decline in federal deficits in fiscal 2022, which ended on 30 September 2022, according to data from the Treasury Department. Surging tax revenue—thanks to a strong economy that drew more people into the labor market, increasing the amount collected in individual and corporate taxes—and waning pandemic spending, helped cut the budget gap in half. The annual budget shortfall totaled US\$ 1.37 trillion, compared to US\$ 2.77 trillion in the previous fiscal year (figure 25).

These trends of higher tax revenue and lower spending have not continued in fiscal 2023, however. Government spending has not dropped precipitously as last year since the pandemic support has already been curtailed. Moreover, rapid increases in interest rates have led to a slowing economy and lower tax receipts, as well as higher borrowing costs for the government.

For the first five months of the 2023 fiscal year that started on 1 October 2022, the cumulative deficit came to US\$ 723 billion, up US\$ 247 billion, or 52%, from the comparable period of fiscal 2022, when the deficit was US\$ 476 billion. Receipts fell 4% to US\$ 1.735 trillion, while outlays grew 8% to US\$ 2.458 trillion. The biggest drivers of the deficit increase in FY2023, according to Treasury data, have been interest on the public debt, which is up US\$ 69 billion, or 29%; higher individual tax refunds, also up US\$ 69 billion, or 136%; lower Federal Reserve earnings, down US\$ 47 billion, or 99%; and higher Social Security costs, up US\$ 45 billion, or 9%.

¹² Capital Economics, “Fed’s Balance Sheet (H.4.1) (Mar.16th)”, US Rapid Response, analysis by Paul Ashworth, 16 March 2023.

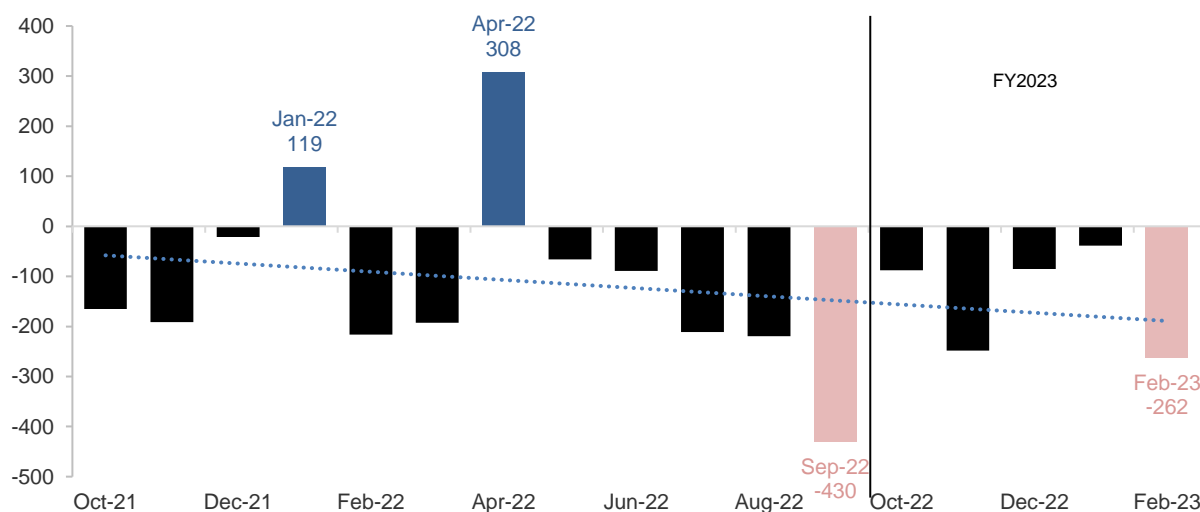
Figure 25
United States federal deficit, FY2002—FY2022
(Trillions of Dollars)



Source: ECLAC Washington Office, based on data from the U.S. Treasury Department <<https://fiscaldata.treasury.gov/americas-finance-guide/national-deficit/>>

In February 2023, the latest monthly data available, the U.S. government posted a US\$ 262 billion budget deficit, up 21% from a year earlier (figure 26). Outlays grew and revenues fell, due largely to higher tax refunds issued as the Internal Revenue Service worked through a substantial backlog of unprocessed returns. Receipts for the month fell US\$ 28 billion, or 10%, to US\$ 262 billion, while outlays grew US\$ 18 billion, or 4%, to US\$ 525 billion. Individual tax refunds, which reduce revenues, grew US\$ 31 billion, or 153%, to a total of US\$ 52 billion.

Figure 26
United States federal surplus or deficit [-], November 2019—November 2022
(Millions of Dollars, Monthly, Not Seasonally Adjusted)



Source: ECLAC Washington Office, based on data from the U.S. Treasury Departments and FRED Graph Observations, Federal Reserve Bank of St. Louis.

As a result of a divided government, with the House of Representatives under Republican control and the Senate under Democratic control, the federal government's finances have once again become a point of contention and uncertainty for the economy and global markets. Some Republican representatives have said they will not be willing to raise the country's borrowing limit without an agreement on broad cuts to the federal budget.

President Biden's proposed FY2024 budget, which was unveiled in early March, contains new steps to reduce deficits while defending popular federal programs, relying instead almost exclusively on taxing corporations and high earners as the way to reduce growth in the deficit by nearly US\$ 3 trillion over the next decade. House Republicans have blamed Mr. Biden's spending policies for stoking inflation and say his tax proposals would further burden people and business owners already struggling with high prices.

According to the International Monetary Fund's recently released chapter 2 of the April 2023 Fiscal Monitor, high inflation led the United States' net debt burden to fall from 99% of GDP in 2020 to 95% in 2022, despite the country's large pandemic-era budget deficits. Inflation helped bolster tax revenues, which tended to rise in line with prices, while public spending, by contrast, was less sensitive to inflation. High inflation delivered a public finances windfall partly because the surge in prices in 2021-2022 was more than expected by investors, but the benefit to taxpayers at the expense of bond holders is unlikely to be repeated. The IMF's research estimated that an unexpected inflation increase of one percentage point would reduce the share of public debt in GDP by an average of 0.9 percentage points for countries with a debt burden of more than 50% of GDP and called on governments to use the windfall to cut deficits. It also indicated that reducing budgets deficits can help curb price pressures, with a reduction of one percentage point of GDP leading to a 0.5 percentage point fall in inflation.¹³

The U.S. national debt hit its statutory borrowing limit on 19 January 2023. The debt ceiling is the maximum amount of debt the Treasury can issue to the public or to other federal agencies. Since then, the U.S. Treasury has been taking extraordinary measures to cover its payments and drawing down its cash on hand. If Congress does not lift the debt ceiling, the United States could default on its debt sometime between July and September, according to economists' estimates, or even earlier. The stalemate over raising the debt limit is intensifying an already elevated level of financial anxiety. U.S. government bonds have been the world's premier safe asset for decades, largely due to reliable repayments. Defaulting on any of this debt would undermine the confidence of any country or investor who holds these bonds and have profound consequences for the global financial system.

H. Financial conditions

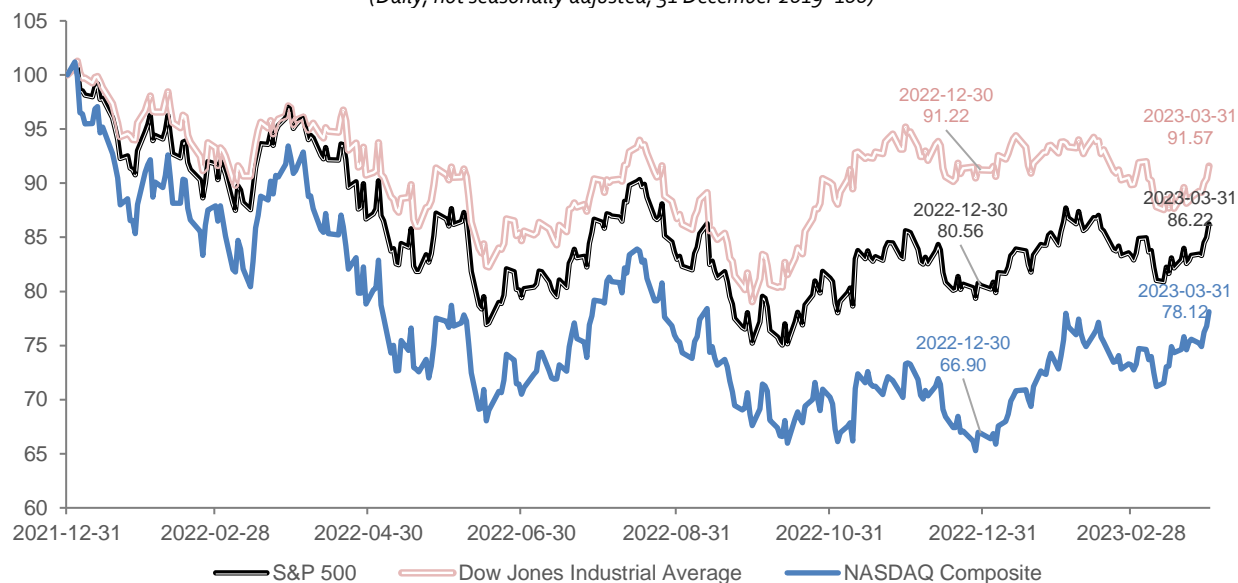
Recent stress in the banking sector has highlighted financial stability risks in an environment of higher interest rates and slowing economic growth. The strength of price and labor market data in the first two months of 2023 led the FOMC to keep taming inflation as the main focus of the United States monetary policy, leading to another interest rate increase in March 2023. However, broader tightening of bank lending conditions should factor into future decisions as to how high the rate should go to bring down inflation.

The United States stock markets were volatile and suffered losses in 2022 (figure 27). After a decade of low interest rates and central bank asset purchases, high inflation is being met by rising interest rates and a slowdown in asset purchases, which have increased financial markets vulnerability. These trends are reducing market liquidity, the ability to transact without dramatically moving prices, and have already increased the risk that sudden price moves in one market (such as the surprising bank collapses in March) will force sales of other market assets, with unpredictable results. This volatility weighed heavily on major indexes in 2022, with the S&P down 16.3%, the Dow Jones Industrial Average down 6.1%, and the NASDAQ down 30.0%. In the first

¹³ IMF April 2023 Fiscal Monitor, Chapter 2, 12 April 2023 <online> <https://www.imf.org/en/Publications/FM/Issues/2023/04/03/fiscal-monitor-april-2023>

quarter 2023, following economic strength early in the year, the S&P 500 and the NASDAQ were up 1.4% and 7.4%, respectively, while the Dow Jones Industrial Average was down about 3.0% (table 3).

Figure 27
U.S. stock market indices, December 2021— December 2022
(Daily, not seasonally adjusted; 31 December 2019=100)



Source: ECLAC Washington Office, based on data from the Federal Reserve of St. Louis (FRED).

Table 3
Stock prices
(Percentage Change)

	S&P 500	Dow Jones Industrial Average	Nasdaq
2020	16.32	7.04	43.75
2021	26.51	18.22	22.63
Q1 2022	-6.06	-4.52	-11.96
Q2 2022	-11.21	-7.59	-16.18
Q3 2022	-1.24	-2.53	-0.14
Q4 2022	1.61	9.24	-4.94
2022	-16.31	-6.06	-29.96
Q1 2023	1.44	-2.98	7.36

Source: ECLAC Washington Office, based on data on Monthly Stock Prices, Economic Indicators, U.S. Government, <<https://www.govinfo.gov/app/collection/econ/>>. Annual and quarterly data are averages of monthly figures. Monthly stock prices data are averages of daily closing prices.

Liquidity has also dried up in the U.S. Treasury market, as the Federal Reserve has hiked interest rates at a rapid pace and major holders of Treasury debt such as the Federal Reserve and the Bank of Japan have retreated. Uncertainty and volatility in the Treasury market in 2022 made Treasury notes harder to trade.

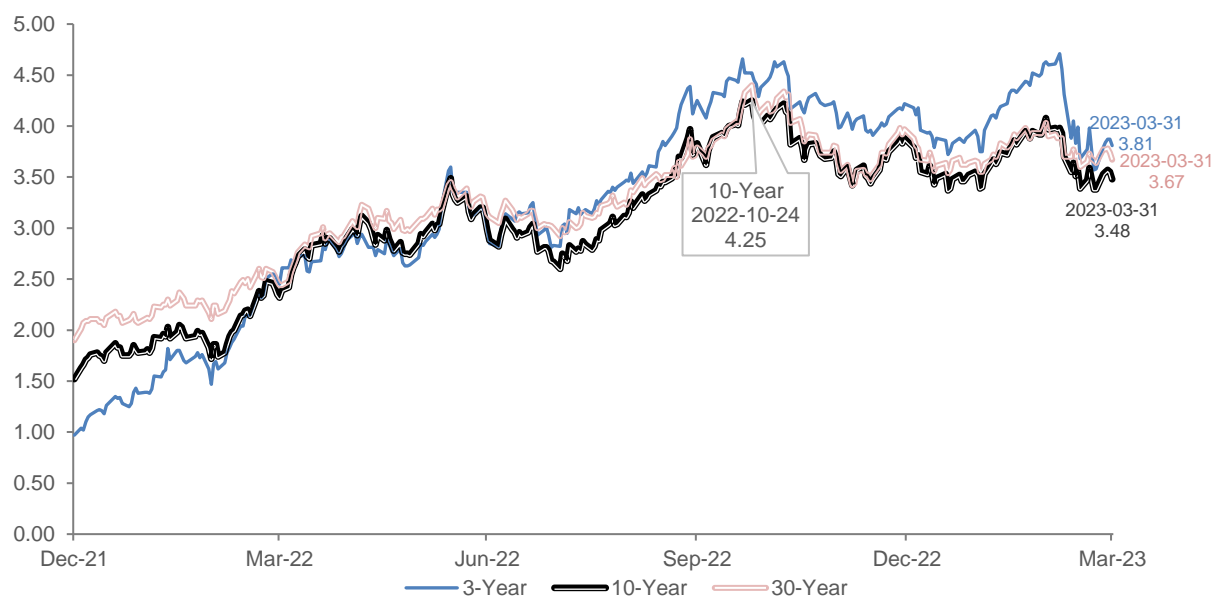
In 2022, the 3-year, 10-year and 30-year Treasury yields surged 326%, 146% and 98%, respectively (table 4). The average yield on the benchmark U.S. 10-year Treasury note reached over 4% in October 2022 for the first time in a decade amid concerns of surging inflation pressures and slowing economic growth. The yield on this government bond benchmark has profound effects on the U.S. economy, feeding into higher home mortgage rates and borrowing costs for companies. It also has profound effects overseas, feeding into higher borrowing costs for emerging market sovereign and corporate debt issuers. The Treasury yield curve started to flash a recession signal in mid-2022, with the 10-year yield below the rate on three-month Treasury notes (figure 28). However, this trend has shown signs of reversal in the first quarter of 2023.

Table 4
U.S. Treasury security yields
(Percentage Change)

	3-year	10-year	30-year
2020	-88.34	-50.00	-27.39
2021	400.00	58.06	10.78
Q1 2022	120.00	44.90	30.27
Q2 2022	50.72	47.42	34.85
Q3 2022	23.17	12.10	9.54
Q4 2022	4.38	2.84	2.81
2022	326.32	146.26	97.84
Q1 2023	0.99	1.10	3.01

Source: ECLAC Washington Office, based on data on Monthly Yields, Constant Maturities, Economic Indicators, U.S. Government <<https://www.govinfo.gov/app/collection/econ/>>. Annual and quarterly data are averages of monthly figures.

Figure 28
U.S. Treasury security yields, December 2021—March 2023
(Constant maturities; daily yields)



Source: ECLAC Washington Office, based on data from the Federal Reserve of St. Louis (FRED).

Treasury securities, which pay fixed interest rates, are seen as safe and reliable investments. The U.S. Treasury has always issued fixed-income securities to finance government projects, but it has been particularly active in the past 10 years, when it financed government initiatives and programs such as the tax cuts passed during the Trump administration and the COVID 19-era stimulus programs passed under both the Trump and Biden administrations. However, as interest rates climbed in 2022, long-term bonds tied to older, lower rates, became less valuable.

The banking sector recent turmoil has been primarily concentrated among midsize and small banks. This is in contrast with the global financial crisis in 2008, when the largest players were at the center of the turbulence. Because of the upsurge of new deposits from pandemic-era savings and stimulus, banks increased their assets with bonds and other fixed-rate investments such as Treasury notes and mortgage-backed securities, with a growing share of these deposits exceeding the FDIC insured limit of US\$ 250,000. In March 2023, the sudden collapse of Silicon Valley Bank (SVB) and the failure of the Signature Bank that followed, were partly driven by assets that lost value when interest rates rose from near zero.

SVB, with fixed-rate securities making up nearly 60% of its assets at the end of 2022 and the vast majority (97%) of its deposits being uninsured,¹⁴ was particularly vulnerable to fears of a bank run that became self-fulfilling. With the bank's customers withdrawing US\$ 42 billion in just 24 hours, SVB was forced to sell its securities at a large loss. Risk management failures, as bank executives failed to address clear interest-rate and liquidity risks, and regulatory failures, have been raised as contributing factors to the bank's collapse, which has led to turmoil in the banking sector.

- **Regulatory issues:** the Federal Reserve defines several categories of institutions that it regulates, including large financial institutions, community and regional financial institutions, and foreign banking organizations. For regulatory purposes, the Fed further categorizes banks by asset size, including large banks with assets of US\$ 100 billion or more, regional banks with assets between US\$ 10 billion and US\$ 100 billion, and community banks with assets below US\$ 10 billion.¹⁵ In May 2018, the U.S. Congress eased rules for midsize and regional banks, weakening regulatory oversight on regional banks such as the SVB. The approved bill allowed banks with up to US\$ 250 billion in assets to escape some of the toughest rules put in place by the Dodd-Frank Act in 2010 to shore up the banking system. This easing of rules has been raised by some as a contributor factor to SVB's collapse. Former SVB's CEO, who lobbied the U.S. Congress to roll back Dodd-Frank's most stringent restrictions on banks of its size, argued that SVB, like other mid-sized banks peers, did not present systemic risks, which has recently proved untrue.

There has also been criticism of the overall regulatory framework, including the commitment to stress-testing systemically important banks against risks. The criticism is that these tests have been static and have used the same set of scenarios. In 2022, banks were stressed against "a severe global recession accompanied by a period of heightened stress in commercial real estate and corporate debt markets", the same as in 2021 and 2020, and failed to contemplate a scenario of rapid interest rate increases.

- **Risk management failures:** at a hearing before the Senate Banking Committee in March on the collapse of the Silicon Valley Bank, Michael Barr, the Federal Reserve's vice chairman for banking supervision, argued that "the bank failed because its management failed to appropriately address clear interest-rate risk and clear liquidity risk", adding that those concerns were initially highlighted by supervisors of the bank in November 2021. Mr. Barr was particularly critical of the absence of a chief risk officer at SVB, as well as its lack of preparation for rising interest rates that caused its assets to decline in value. Mr. Barr faulted SVB's management for not acting with greater urgency to address what he called "really basic" banking risks.

Following the collapse of SVB, Signature Bank also collapsed. In the case of Signature Bank, 90% of its deposits were uninsured.¹⁶ As said in the overview, they were the two main banks for crypto companies, with SVB having crypto startups and venture capitalists as customers. The banks' collapse came just days after the shutdown of the crypto lender Silvergate Capital Corp. What seemed to be a specific plight to crypto-currency focused banks, however, rapidly morphed into a crisis with economic, political and international repercussions, with investors soon growing increasingly concerned about First Republic Bank and Credit Suisse Group.

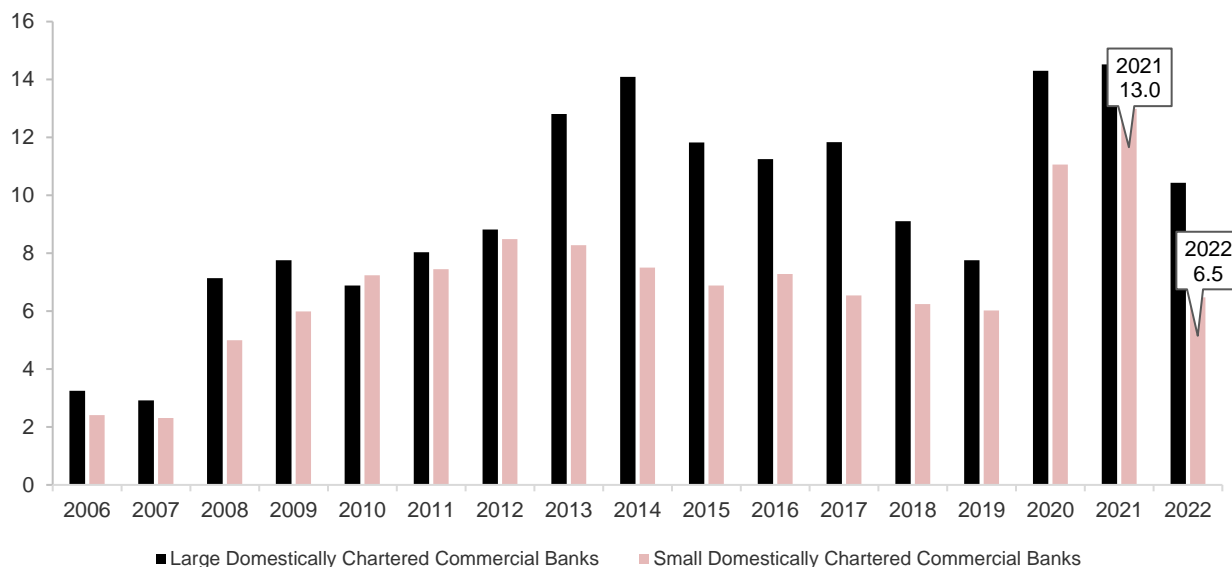
The largest U.S. regional banks began this year with less cash on hand than at any time since the 2008 financial crisis, leaving them ill-prepared for a rush of deposit withdrawals that led to the collapse of SVB and Signature Bank. As they adapted to rising interest rates, the thirty banks with assets between US\$ 50 billion and US\$ 250 billion cut the percentage of their assets held in cash to an average 6.5% at the start of 2023, from 13% a year before, according to data from the Federal Reserve (figure 29). This left regional banks vulnerable to deposit outflows and to the risk of being destabilized by losses on forced sales of their securities in response to customers withdrawing their deposits.

¹⁴ Mrinalini Krishna, "How Much Of Regional Bank Deposits Are Not FDIC Insured?", Investopedia, 15 March 2023 <<http://www.investopedia.com/regional-insured-deposits-725798>>

¹⁵ Moody's Analytics, "U.S. Bank Data Primer" by Damien Moore and Martin Wurm, Daily Economic Roundup, 3 April 2023.

¹⁶ Investopedia, "How Much Of Regional Bank Deposits Are Not FDIC Insured?" by Mrinalini Krishna, 15 March 2023

Figure 29
U.S. banks: cash as a share of total assets at the end of year by bank size, 2006–2022
(Annual percentage, seasonally adjusted)



Source: ECLAC Washington Office, based on data from the Federal Reserve of St. Louis (FRED). Combination of two series: Cash Assets and Total Assets in Small and Large Domestically Chartered Commercial Banks, billions of dollars, seasonally adjusted. Source of the series: Federal Reserve, H8 Assets and Liabilities of U.S. Commercial Banks. Large Domestically Chartered Commercial Banks are defined as the top 25 domestically chartered commercial banks ranked by size.

Rapid interest rate increases squeezed the income of small and midsize banks, which rely more on the difference between short-term and long-term interest rates, as they get less revenue than larger banks from investment banking, asset management, or credit cards. In addition, deregulation also allowed these banks to hold less cash. Before the easing of Dodd-Frank rules passed in 2018, liquidity rules forced all banks to hold more than 10% of their assets and deposits in cash. As a result, last year midsize and regional banks began to move assets that they had been holding in cash, earning nothing, into bonds that paid modest interest income. However, this move was a risk, should the bank actually need those funds to repay depositors, something that had not been a concern for years. When SVB depositors began asking for their money back last year, the bank found itself short of cash to meet their demands. It ended up selling some bonds at a US\$ 1.8 billion loss, which alarmed investors and led to the unravelling of the bank.¹⁷

The lack of liquidity has become a major issue for regional banks well beyond SVB and Signature Bank. First Republic, a California-based bank that entered 2023 with just 2% of its assets in cash, experienced large deposit outflows after the failure of SVB, and its shares plunged 90%. Ultimately, eleven of the United States largest banks agreed to deposit US\$ 30 billion in cash with the bank, stabilizing its share price. In contrast, Citigroup had nearly 25% of its deposits in cash at the end of last year, the most out of the large banks.¹⁸

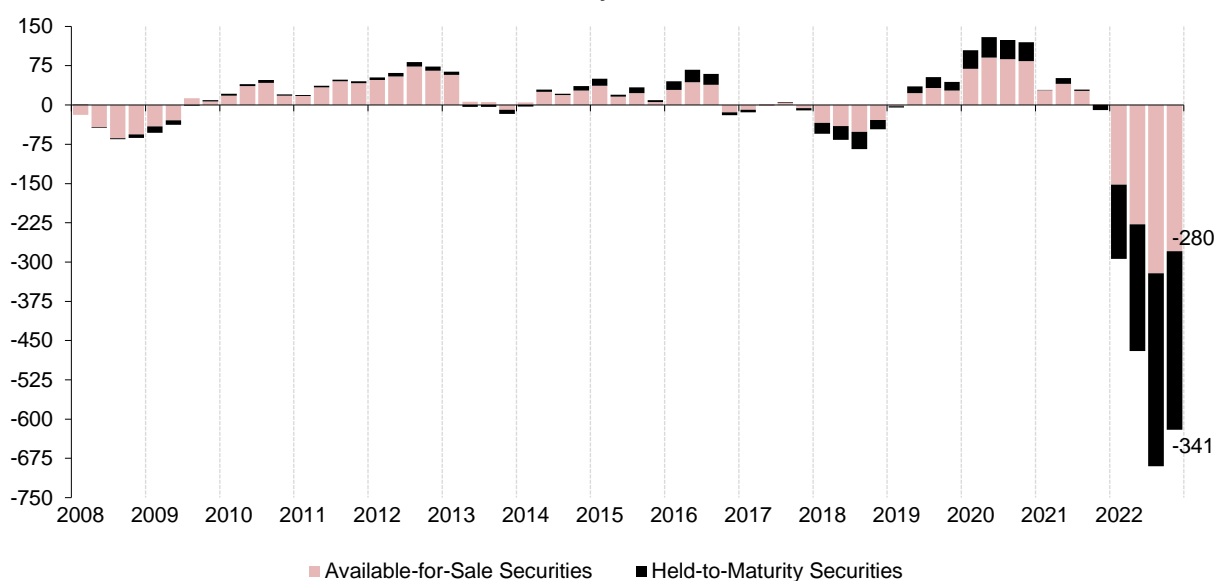
Interest risk has had an impact on banks' losses. Under accounting rules, banks do not have to recognize losses on most of their holdings unless they sell them. Unrealized losses have ignited concerns following the March turmoil in the banking sector. According to remarks by FDIC Chairman Martin Gruenberg at the Institute of International Bankers on 6 March 2023, "the current interest rate environment has had dramatic effects on the profitability of banks' funding and investment strategies." Since as a result of the higher interest rates, "longer term maturity assets acquired by banks when interest rates were lower are now worth less than their face values", most banks have some amount of unrealized losses on securities, and "the total of these

¹⁷ Financial Times, "US regional banks reduced cash buffers ahead of run in deposits" by Stephen Gandel, 3 April 2023.

¹⁸ Ibid.

unrealized losses, including securities that are available for sale or held to maturity, was about US\$ 620 billion at yearend 2022¹⁹ (figure 30). Unrealized losses on commercial real-estate debt securities reached US\$ 43 billion in the fourth quarter, FDIC data show. Banks held US\$ 444 billion of these securities at the end of 2022, and investors see commercial real estate as another source of financial risk. Rapid monetary tightening and weak risk management amplify banks' underlying asset-liability risk.

Figure 30
U.S. banks: unrealized gains (losses), 2008–2022
(Billions of dollars)



Source: FDIC <<https://www.fdic.gov/analysis/quarterly-banking-profile/>>

Note: Insured Call Report filers only.

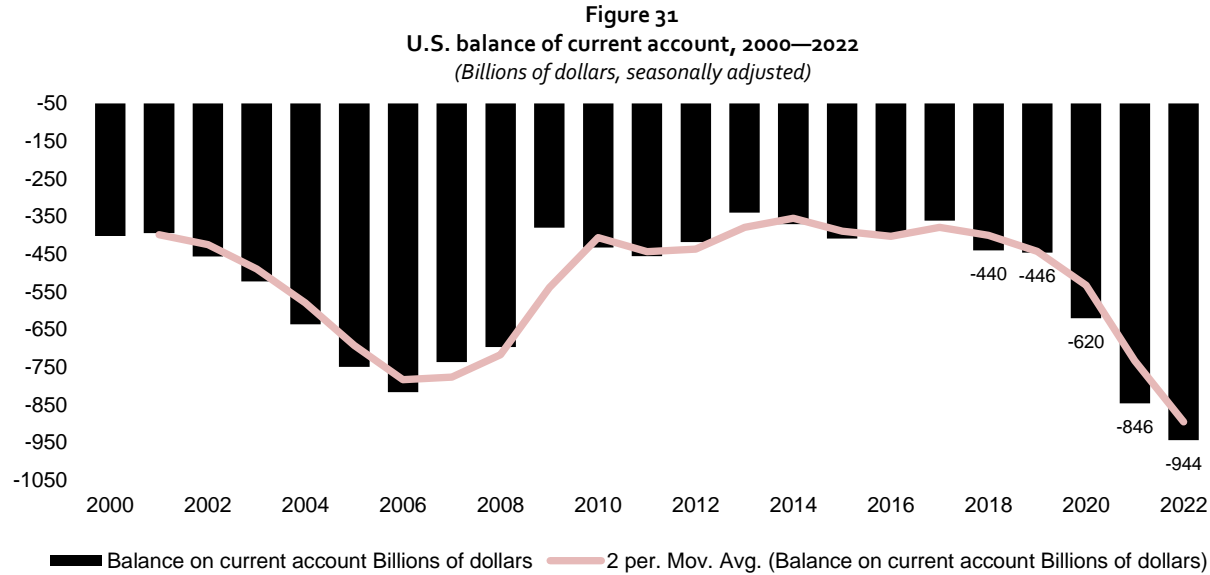
Households and businesses are likely to find it harder to get loans because of turmoil in the banking industry, which is expected to dent economic growth and raise the risk of recession. Banks that are smaller than the top twenty-five largest, account for around 38% of all outstanding loans and for 67% of commercial real estate lending, according to Federal Reserve data. These banks are thus crucial drivers of credit growth, the fuel that powers the economy, but are likely to respond to recent stress in the banking sector by tightening standards and slowing lending to raise capital ratios. Fears that the United States economy will enter a recession later this year, triggered by a pullback in lending from smaller banks, have sharply increased.

I. External sector

The external sector did not support annual United States economic growth in 2022. There was a negative contribution from net exports (figure 2, p.8), which subtracted 0.4% from 2022 growth. The U.S. current account deficit, which reflects the combined balances on trade in goods and services and income flows between U.S. residents and residents of other countries, increased US\$ 97 billion in 2022 from 2021, or 12%. This was however a much smaller increase than in the previous two years, when the current account widened 39% in 2020 and 37% in 2021 (figure 31). Following a sudden substantial increase in the first quarter of 2022, the U.S. current account deficit narrowed in the last three quarters of 2022, according to the U.S. Bureau of Economic Analysis's preliminary fourth-quarter release on international transactions.

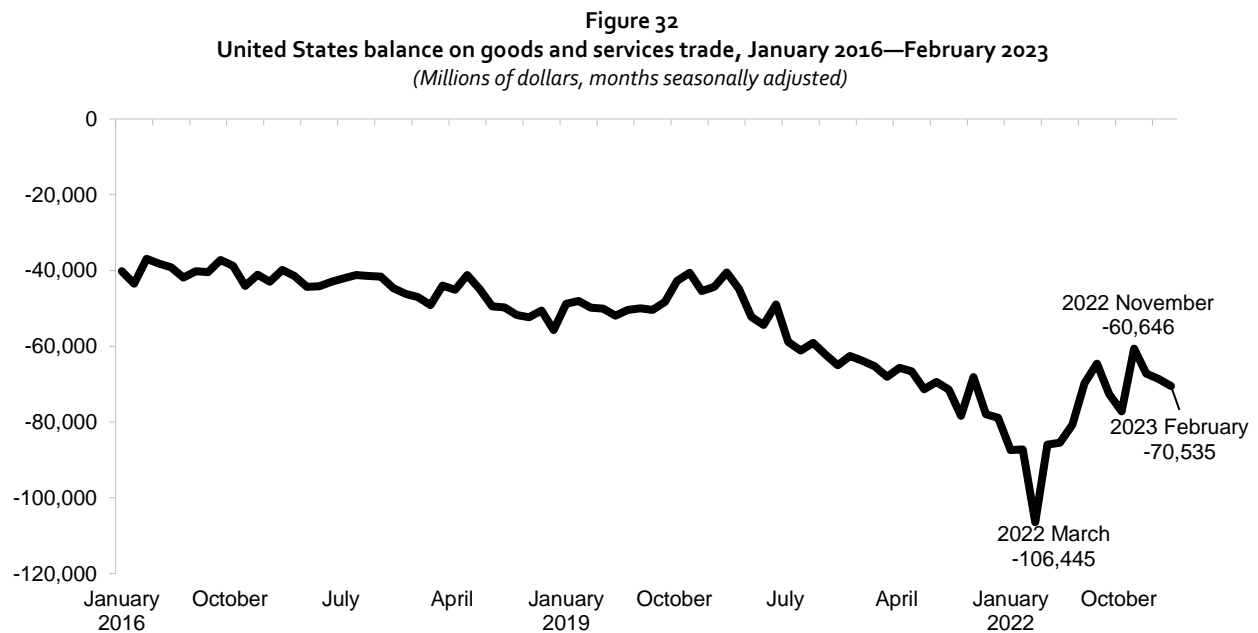
¹⁹ FDIC, "Remarks by FDIC Chairman Martin Gruenberg at the Institute of International Bankers," Last updated: 6 March 2023, FDIC/News/Speeches & Testimony.

The worsening of the deficit in the first quarter of 2022 and the improvement in subsequent quarters were driven by the trade deficit in goods and services, although in the fourth quarter a reduction in the U.S. government's net transfers with foreign nations was the largest contributor to the change. This reflected both an increase in payments to the U.S. government, including penalties and fees, as well as a reduction in U.S. foreign assistance.



Source: U.S. Bureau of Economic Analysis, U.S. International Transactions, 4th Quarter and Year 2022, 23 March 2022.

In February 2023, latest data available, the U.S. trade deficit in goods and services grew to US\$ 70.5 billion from US\$ 68.7 billion in January, according to data released on 5 April by the Bureau of Economic Analysis (figure 32). The widening of the nominal trade deficit reflected a 2.7% month-on-month decline in exports, which was partially offset by a 1.5% fall in imports. The declines add to the signs that economic growth will slow, although strong gains in January suggest that international trade is likely to have risen over the first quarter as a whole.



Source: U.S. Census Bureau and the Bureau of Economic Analysis, U.S. Commerce Department.

Exports fell by US\$ 6.9 billion, as a US\$ 8.5 billion decrease in goods exports was partly offset by an increase in exports of services. Declines were seen broadly across manufactured goods, with the largest drops occurring in industrial supplies, automotive vehicles and consumer goods, each of which had seen large rises in January. Over the two months of 2023, however, exports are up 9.6% and higher across all categories than in the same period in 2022.

Imports of goods and services fell by US\$ 5 billion, a US\$ 5.8 billion reduction in goods imports, softened by a US\$ 800 million increase in services imports. The entire drop in goods imports was attributable to reduced purchases of consumer goods and automotive vehicles. Imports of consumer goods over the first two months of the year are down 8.9% from a year earlier. Imports of industrial supplies (down 6.8%), have fallen to their lowest level since October 2021.

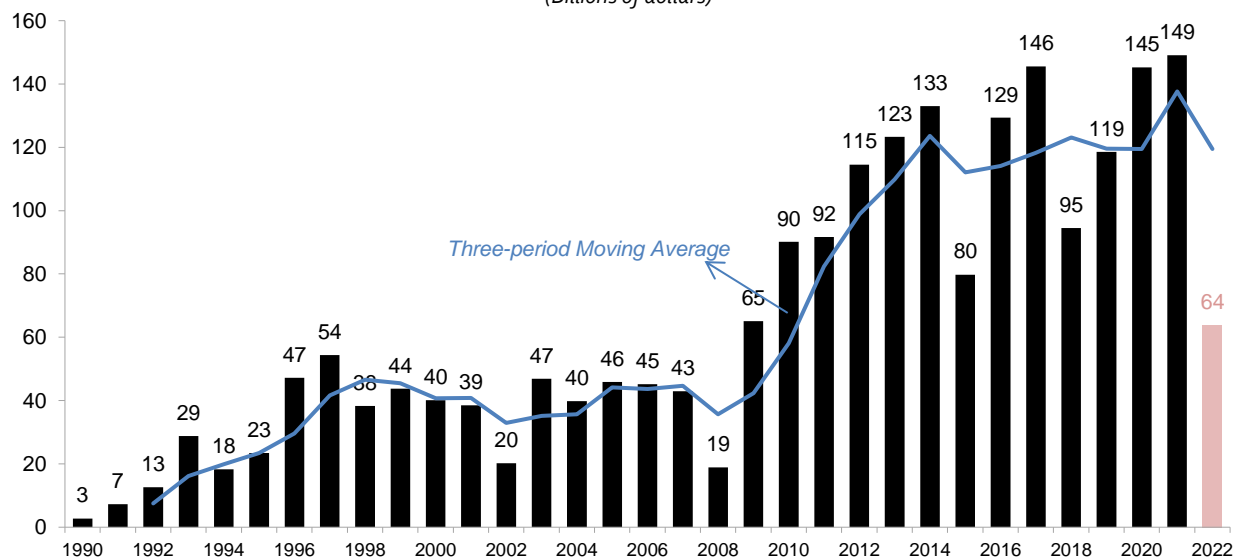
On net, U.S. trade is expected to contribute positively to real GDP in the first quarter of 2023, with real exports outpacing imports, but risks are weighted to the downside. According to Moody's, the recent slide in the U.S. dollar can provide some support to exports this year, but it remains valued quite strongly by historical benchmarks and the elevated level of uncertainty around the solvency of global financial institutions, as well as the volatility in the bond market, reduces confidence in the outlook for currency markets.²⁰

²⁰ Moody's, Indicators, United States International Trade (FT 9000), by Mark Hopkins, 5 April 2023.

II. Impact on Latin American and Caribbean financial conditions

Inflation concerns, the United States Federal Reserve’s tightening monetary policy stance and the strength of the dollar contributed to push Latin America and the Caribbean (LAC)’s funding costs higher in 2022. Against the backdrop of higher global interest rates and borrowing costs, LAC issuers placed US\$ 64 billion worth of bonds in international bond markets in 2022, down 57% from 2021 and with an average coupon that was 1.3% higher, and an average maturity that was three years lower (figure 33).

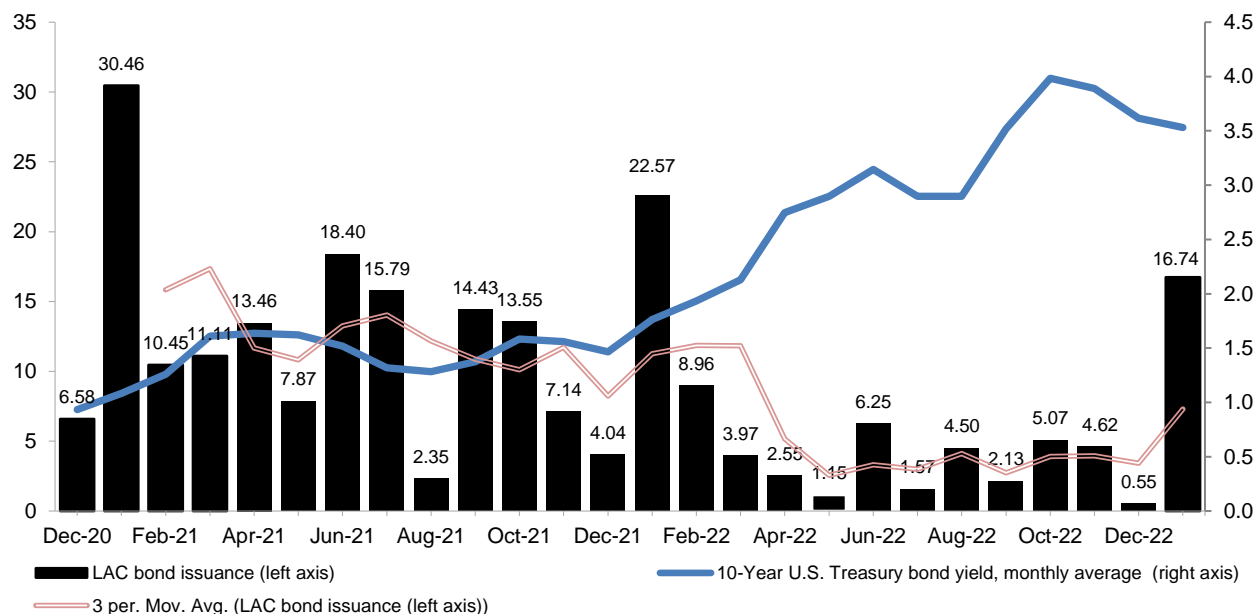
Figure 33
Annual Latin American and Caribbean (LAC) international bond issuance, 1990–2022
(Billions of dollars)



Source: ECLAC, Capital flows to Latin America and the Caribbean: 2022 year-in-review and early 2023 developments (LC/WAS/TS.2023/1), Santiago, 2023 <online> <https://www.cepal.org/en/publications/48733-capital-flows-latin-america-and-caribbean-2022-year-review-and-early-2023>

In addition, increased volatility in government bond markets carried the yield on the 10-year U.S. Treasury note—a benchmark for global borrowing costs—above 4% for the first time in a decade in October 2022, feeding into higher borrowing costs and lower international debt issuance for the region’s sovereign and corporate debt issuers alike (figure 34).

Figure 34
LAC international bond issuance and 10-year U.S. Treasury yield, December 2020—January 2023
(Left axis, billions of dollars; Right axis, percentage)



Source: ECLAC, Capital flows to Latin America and the Caribbean: 2022 year-in-review and early 2023 developments (LC/WAS/TS.2023/1), Santiago, 2023 <online> <https://www.cepal.org/en/publications/48733-capital-flows-latin-america-and-caribbean-2022-year-review-and-early-2023>

The shift by the Federal Reserve and other central banks towards a tightening stance put LAC assets under pressure in 2022 and led to capital outflows. The war in Ukraine compounded external risks. The international market remained open to investment grade and some stronger high yield issuers from the region, but coupons and issuance concessions increased. Lower funding needs and greater reliance on local markets helped LAC issuers to offset some of the pressure from international investors' lower risk tolerance in 2022.

In January 2023, LAC bond issuance increased to US\$ 16.7 billion from only US\$ 550 million in December 2022 on the expectation that a period of rising global interest rates would be nearing its peak and on anticipation of China's economic reopening. January has historically experienced a high volume of bond issuances and January 2023 was no exception, although it was not as busy as in previous years. While January 2020, January 2021 and January 2022 represent the region's first, third and seventh largest monthly amounts overall since 2000, January 2023 ranked 20th.

However, in light of the recent bank failures in the United States, the outlook for the region's financing conditions has become a concern once again. Even as the effects of the U.S. banking sector turmoil recede, investors have adopted a "risk off" approach to high-yield debt, which could impair the ability of some of the region's sovereign and corporate issuers to raise funds in international bond markets.

Domestically, strains in the global banking sector have flared at a time when the region is already experiencing economic weakness. According to analysis by Capital Economics, although the banks in the region have so far remained out of the turmoil, the impact of the recent turbulence on commodity prices could dampen the prospects for domestic demand in the region. Moreover, the region's domestic credit conditions may tighten as result, compounding the effects of aggressive monetary tightening cycles over the past two years.²¹

²¹ Capital Economics, "Global turmoil hits Lat Am when it's already down" by William Jackson, Jason Turvey and Kimberley Sperrfechter.

III. Looking ahead

The United States economy improved in the second half of 2022 and momentum carried over into early 2023. The labor market has remained historically tight, with more than one million jobs added in the first quarter of 2023 and March marking the 27th consecutive month of job gains, but it is gradually cooling down. The unemployment rate remains near a record low.

Inflation is also gradually decelerating, as the economy overcomes supply chain disruptions and the aggressive tightening in monetary policy begins to work towards reducing excess demand. While inflation started in goods affected by supply chain issues, as supply chain pressures eased, the prices of services rose. For the 12 months ended in February 2023, core service prices were up 7.3% according to data from the Bureau of Labor Statistics, while core goods prices rose only 1.0% the same month, down from a peak of 12.3% in February 2022.

The Federal Reserve has been focused on developments in the labor market, and according to Chairman Jerome Powell, job and wage growth need to go down substantially more before the central bank pauses its monetary tightening. He has decomposed the central bank's preferred measure of inflation, the core personal consumption expenditure index (at 4.6% in February 2023), into three categories: core goods, housing, and core services excluding housing. Of these three categories, the third is the largest, accounting for more than half of the core PCE deflator. Moreover, core services excluding housing, which encompasses everything from healthcare to hospitality, are labor-intensive, so the degree of tightness in the job market is an informative guide in the path of inflation in service industries.²²

In the press conference following the Federal Reserve's rate-setting meeting on 22 March 2023, Mr. Powell emphasized that there is no evidence yet of a disinflationary trend in the core non-housing services. The Federal Reserve raised interest rates for the ninth consecutive time at that meeting, to a range between 4.75% to 5.00%. More importantly, the central bank projects the benchmark interest rate to rise to 5.1% by the end of 2023, implying at least one more interest rate increase this year.

²² Federal Reserve, "Inflation and the Labor Market", Speech by Chair Jerome H. Powell, 30 November 2022, <https://www.federalreserve.gov/newsevents/speech/powell20221130a.htm> and Moody's, "Federal Reserve Hyper-Focused on Labor Market", analysis by Dante DeAntonio, *Daily Economic Roundup*, 9 December 2022.

Bank stress will likely accelerate the pass-through from tighter monetary policy to the real economy, however. Lending standards had already been tightening for a few quarters and this trend is expected to accelerate as the banking sector tightens credit and stricter banking regulation becomes more likely. Nonetheless, the risk of deposit flight and contagion in funding markets appears to have eased in recent weeks due to the joint action by the United States Federal Reserve, Treasury Department and Federal Deposit Insurance Corporation announced in early March, which seems to have contributed to ease depositors' concerns and to limit the need for banks to liquidate assets into a stressed market.

The stress in the banking sector and tighter financial conditions have added to downside risks to the United States economic outlook. Regional banks play an outsized role in business lending. Business investment, particularly for small businesses and commercial real estate, is likely to come under further pressure as lending conditions tighten. According to analysis by Credit Suisse, around 18% of commercial and industrial (C&I) loans and 67% of commercial real estate loans are held by banks that are ranked below the top-25 largest institutions in size, and it will be difficult for the larger banks to fill the gap from the smaller regional banks' reduction in lending.²³ The U.S. economy is expected to lose momentum going forward.

The combination of persistently strong inflation and tightening credit conditions due to strains in the banking sector leaves the Federal Reserve in a difficult position as it approaches the end of its monetary policy tightening cycle. For now, the central bank is addressing the two by raising interest rates further to tame inflation while also offering generous liquidity support to the banks. Tighter credit conditions are expected to weigh on the economy over time, however, which would contribute to lower demand and inflation, and maybe a reversal in the monetary policy cycle.

Uncertainty has increased, and while some market forecasters project a recession this year, others believe that as long as consumer fundamentals remain resilient, a recession may be narrowly avoided.²⁴ The economic outlook will remain sensitive to incoming data as the impact of tighter credit conditions gradually feeds through the real economy.

²³ Credit Suisse, "Global Economics Quarterly: Inflation remains the main problem, not recession risk," p.11, 30 March 2023

²⁴ Moderating price growth and a tight labor market have allowed real disposable income to increase for eight consecutive months as of February 2023. The personal saving rate rose from 4.4% in January to 4.6% in February. If the U.S. consumer continues to show resilience, the severity of a potential economic downturn may be limited and likely short-lived.

The United States economy grew by 2.1% in 2022. Consumer spending was the main driver of growth. The economic outlook improved in the second half of 2022, following two quarters of negative growth, and this momentum has carried over into early 2023. The labour market was strong in 2022 and continued to show strength in early 2023. Inflation rose to 8% in 2022, the highest annual level in four decades, but slowed to 5% in March 2023. The Federal Reserve approved nine interest rate increases between March 2022 and March 2023 to tame inflation. March 2023 saw heightened market stress owing to bank failures that were partly driven by the loss of asset value as interest rates rose from near zero. Unease about the banking system's stability and a political stalemate over raising the debt limit are adding to an already high level of financial anxiety, as the two economic challenges become intertwined.

The *United States economic outlook* reports are published three times a year and follow the main macroeconomic developments of the United States economy and how they could affect financial conditions in Latin America and the Caribbean.