

Inflation May Have Peaked

Consumer Spending Remains Robust

Despite pervasive pessimism among consumers and small business operators, consumer spending continues to drive the economy. Spending at restaurants and bars increased in July 2022, up 0.1% for the month and 11.6% year over year. This outpaced overall retail sales, which were flat in July and are up 10.3% year over year. Spending has persisted despite sky-high food prices, but consumers have shown a willingness to tolerate higher prices in several segments, including air travel and e-commerce.

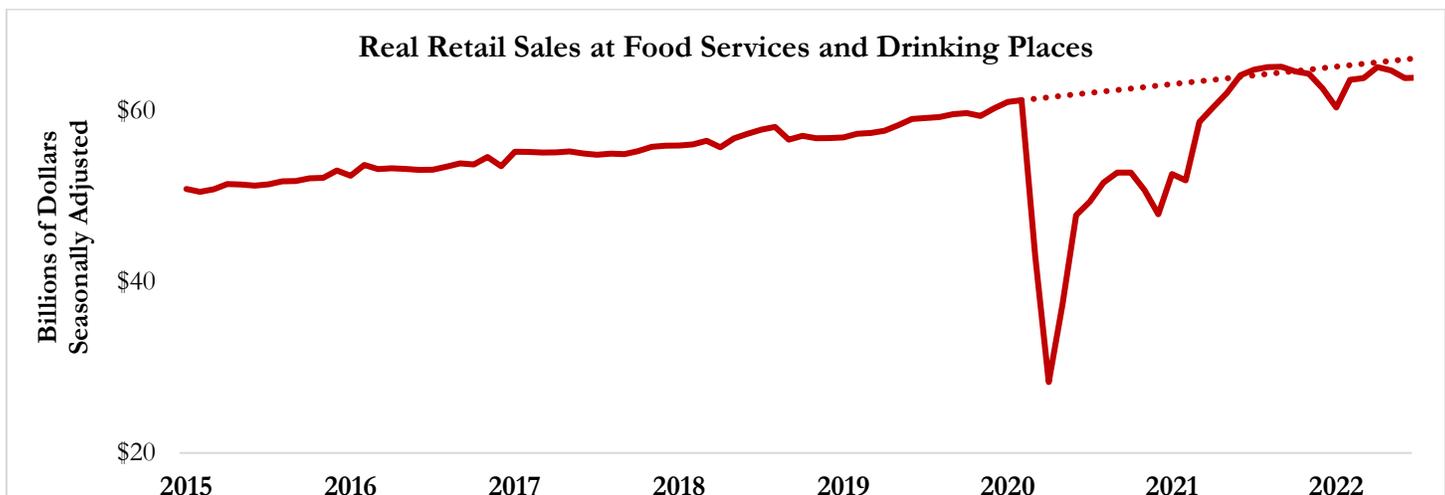
After more than a year of elevated inflation, the Consumer Price Index remained unchanged in July 2022. Year-over-year inflation still registered 8.5% for the month, but that was down from June's 9.1% pace. Lower fuel prices represented the major player in suppressing inflation. The Producer Price Index, which measures the change in average prices domestic producers receive for the output, declined 0.5% in July, yet another indication that inflation has likely peaked (provided we avoid a major event such as a Chinese invasion of Taiwan or widespread strikes among supply chain workers). Financial markets have responded by rallying under the theory that increasingly benign inflation data will induce the Federal Reserve to tighten monetary policy more aggressively. Many market participants have already begun to predict interest cuts at some point in 2023.

But for now, the Federal Reserve appears intently focused on curbing inflation and restoring inflation to its 2% target. The Federal Reserve began its monetary tightening in March in earnest, but raising its benchmark interest rates by 0.25 percentage points. May generated a 0.5 percentage point rate increase. Then came two 0.75 percentage point rate hikes in June and July. There are more rate hikes to come, with risk of recession rising with each Federal Reserve meeting.

For now, the economy appears to be growing. The nation added 528,000 jobs in July, well above consensus expectations. Unemployment dipped to 3.5%, matching its pre-pandemic level, which itself represented a 50-year low. The most recent data indicate that there are 1.8 job openings for every unemployed American, which both reflects the strength of the economy but also the reason inflation is poised to remain stubbornly high as employers continue to raise compensation in order to recruit and retain workers.

Three Key Takeaways

1. Inflation may have peaked, but is poised to remain stubbornly high.
2. Labor remains unprecedentedly scarce.
3. Spending at food service and drinking places outpaced overall retail sales in July.



Source: U.S. Census Bureau

A Slew of Supply Side Threats

The U.S. post-pandemic economy has been characterized by abundant demand and constrained supply. While the Federal Reserve is raising interest rates in an effort to dampen demand, thereby curbing inflationary pressures, supply side improvement would be profoundly helpful in terms of bringing the economy back into equilibrium.

Unfortunately, there are several risk factors facing the supply side of the global economy. There is, of course, Russia's invasion of Ukraine. While some of the negative supply impacts of that conflict have already been felt (oil prices, wheat shortages, etc.), some are more subtle in nature. For instance, major ports in Europe are currently backed up due to containers that were bound for Russia that now have nowhere to go.

That's hardly where the problems end. Europe faces an energy crisis, record heat waves, shrinking rivers, and double-digit year-over-year inflation. The British government has already urged its populace to prepare for a protracted recession.

China's economy also exhibits substantial weakness, including a burgeoning real estate crisis. The insistence on zero-Covid policies hasn't helped, at least in terms of supporting economic momentum. The Ningbo-Zhoushan port, the world's third largest in terms of container volume, remains partially shutdown as of this writing—six days and counting—due to a single positive Covid test from a dockworker. It is unclear when it will reopen.

The news has been better in America. Supply chain challenges have been easing since December, at least according to certain data series. According to the Federal Reserve Bank of New York's Global Supply Chain Pressure Index (GSCPI), supply chain pressures peaked in December 2021 at their highest level during the nearly 25-year history of the data series. Since December, the GSCPI has declined 57.5% and is at its lowest level since January 2021, although the reading remains significantly above its historical average.

Food Service Spending Holds Up For Now

Retail sales at food service and drinking places edged higher in both real and nominal terms in July. Data from OpenTable indicate that the number of seated diners at U.S. restaurants is virtually the same as it was pre-pandemic (+1% for the week ending 8/18/22 compared to the same week in 2019).

Gas prices have fallen rapidly since its mid-June peak—down more than \$1/gallon according to the Energy Information Administration. Not only has that helped to improve consumer sentiment, but it has also positively impacted consumer discretionary spending power.

But that consumer discretionary spending power is being put to the test by stubbornly high inflation. Though overall inflation may have peaked, prices for food at home have continued to rise. This pattern has been in place since 2021's earliest days.

The USDA recently raised its forecast for food price increases in 2022. The agency now expects that all food prices will expand between 8.5% and 9.5% in 2022. Prices for food-away-from-home (e.g., restaurants) are expected to rise 6.5-7.5%. Prices for food at home are expected to expand 10-11%

In short, inflation is hammering away at consumer finances. A strong employment market has helped to offset that, but there are indications that employers' collective appetite to hire additional workers has begun to wane. More Americans have opened credit card accounts and balances are on the rise. Much of the global economy is weakening. Inflation is much worse in many other nations relative to America.

All of these factors, along with ongoing Federal Reserve monetary tightening, raise the risk of recession, which remains high despite current economic momentum. Indeed, the prudent food distributor should build the elevated possibility of recession into their budgets, marketing strategies, staffing models, and pricing models for 2023.

The Outlook

For now, the U.S. economy seems to be in good shape. Consumers continue to spend, including at restaurants and on travel. Employers collectively continue to look for additional workers, another indication that the economy continues to expand despite some poor readings on real gross domestic product earlier this year. But we are hardly out of the proverbial woods. Worker shortages, war in Eastern Europe, economic lockdowns in China, domestic supply chain disruptions and other phenomena continue to contribute to elevated inflation. The Federal Reserve was slow to respond to emergent inflation in 2021 and is trying to make up for lost time. Despite some indications of easing inflation, the Federal Reserve remains committed to rate tightening during the months ahead. With borrowing costs rising, consumer and small business pessimism remaining elevated, and credit card balances expanding, the U.S. economy is poised to decelerate at some point in the near future, perhaps during the early months of 2023. Risk of an official recession over the next 12 months remains elevated.

Industry at a Glance

	Value			Change From		Forecast
	Jul-22	Jun-22	Jul-21	Jun-22	Jul-21	Aug-22
Labor Market						
Payroll Employment (thousands)	152,536	152,008	146,387	0.3%	4.2%	152,839
Average Hourly Wages	\$32.27	\$32.12	\$30.67	0.5%	5.2%	\$32.38
Unemployment Rate	3.5%	3.6%	5.4%	-0.1 pp	-1.9 pp	3.5%
Labor Force Participation Rate	62.1%	62.2%	61.7%	-0.1 pp	0.4 pp	62.2%
Retail Sales (\$ Millions)						
Retail & Food Service Sales	\$682,815	\$682,585	\$619,180	0.0%	10.3%	0.2%
Grocery Stores	\$70,806	\$70,661	\$64,852	0.2%	9.2%	UP
Food Service & Drinking Places	\$86,050	\$85,991	\$77,074	0.1%	11.6%	UP
Consumer Price Index						
Food and Beverages	306.0	302.8	277.0	1.1%	10.5%	UP
Food at Home	292.5	288.6	258.6	1.3%	13.1%	UP
Food Away from home	331.3	329.0	308.0	0.7%	7.6%	UP
Producer Price Index						
Food Manufacturing	255.4	255.5	225.3	0.0%	13.3%	UP
Frozen Food Manufacturing	160.9	159.8	137.6	0.7%	17.0%	UP
Pork Products Except Sausage	160.8	161.6	174.2	-0.5%	-7.7%	UP
Beef & Veal Products, Fresh or Frozen	259.5	237.0	271.6	9.5%	-4.4%	UP
Processed Poultry	234.8	239.1	185.6	-1.8%	26.5%	UP
Processed Fruits & Vegetables	245.0	242.5	217.8	1.1%	12.5%	UP
Truck Transportation	201.9	202.8	164.0	-0.4%	23.1%	DOWN
Crude Oil WTI (NYM \$/bbl)						
Front Month Crude Oil Price	8/12/22	7/8/22	8/13/21	7/8/22	8/13/21	Sep-22
	\$92.09	\$104.79	\$68.44	-12.1%	34.6%	DOWN
Real Gross Domestic Product						
	2022-Q2	2022-Q1	2021-Q4	-	-	2022-Q3
% Change from Preceding Period	-0.9%	-1.6%	6.9%	-	-	1.6%
Personal Consumption Expenditures (\$ Billions)						
	Jun-22	May-22	Jun-21	May-22	Jun-21	Jul-22
Total PCE	\$16,291	\$16,076	\$14,546	1.3%	12.0%	UP
Food PCE	\$1,274	\$1,265	\$1,152	0.7%	10.6%	UP

Glossary

Indicator	Source	Definition/Notes
Labor Market Terms		
Payroll Employment	Bureau of Labor Statistics (BLS); Current Employment Statistics (CES) Survey, also known as the Establishment Survey	Payroll employment, also commonly known as Total Nonfarm or Total Nonfarm Payroll, is a measure of the number of U.S. workers in the economy that excludes proprietors, private household employees, unpaid volunteers, farm employees, and the unincorporated self-employed. This measure accounts for approximately 80% of the workers who contribute to Gross Domestic Product (GDP) and provides useful insights into the current economic situation because it can represent the number of jobs added or lost in an economy.
Average Hourly Wages	BLS; CES/Establishment Survey	Average hourly wages, (or average hourly earnings) reflect the average gross earnings per hour among all payroll employees across all private industries in a given month. Average hourly wages are measured as gross payrolls divided by total hours for which employees receive pay—including sick pay or vacation pay—during the pay period that includes the 12th of the month. Average hourly wages are not a measure of total compensation or employers' total compensation costs because they exclude items such as employee benefits, irregular bonuses and commissions, retroactive payments, and the employer's share of payroll taxes.
Unemployment Rate	BLS; Current Population Survey (CPS), also known as the Household Survey	The unemployment rate represents the number of unemployed people as a percentage of the labor force (the labor force is the sum of the employed and unemployed).
Labor Force Participation Rate	BLS; CPS/Household Survey	The labor force participation rate is the percentage of the population that is either working or actively looking for work. In technical terms, it is the number of people in the labor force as a percentage of the civilian noninstitutional population.
Retail Sales		
Retail Sales	Census Bureau; Advance Monthly Retail Trade Survey	Retail sales are estimates of monthly sales for companies in the retail trade and food services sectors. Estimates are derived from the Advance Monthly Retail Trade Survey which is a voluntary survey covering retail companies with one or more establishments that sell merchandise and related services to final consumers. These firms provide data on dollar value of retail sales for selected establishments.
Price Indices		
Consumer Price Index	BLS; Consumer Price Index (CPI) program	The Consumer Price Index (CPI) program measures the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. The CPI measures price changes from the perspective of the consumer.
Producer Price Index	BLS; Producer Price Index (PPI) program	The Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output. The PPI measures price changes from the perspective of the seller.
Gross Domestic Product		
Real Gross Domestic Product	Bureau of Economic Analysis (BEA); National Income and Product Accounts (NIPA)	Gross domestic product (GDP) is the value of the goods and services produced by the nation's economy less the value of the goods and services used up in production. GDP is also equal to the sum of personal consumption expenditures, gross private domestic investment, net exports of goods and services, and government consumption expenditures and gross investment. Real GDP values are inflation-adjusted estimates—that is, estimates that exclude the effects of price changes.
Personal Consumption Expenditures		
Personal Consumption Expenditures	BEA; NIPA	Consumer spending, or personal consumption expenditures (PCE), is the value of the goods and services purchased by, or on the behalf of, U.S. residents. PCE shows how much of the income earned by households is being spent on current consumption as opposed to how much is being saved for future consumption.