The Washington Post
Democracy Dies in Darkness

U.S. may be barreling toward recession in next year, more experts say

'Recession risks are high — uncomfortably high — and rising,' a leading economist says

By Abha Bhattarai
Updated May 19, 2022 at 4:23 p.m. EDT | Published May 19, 2022 at 6:00 a.m. EDT

The U.S. economy could be heading for a recession in the next year, according to growing warnings from banks and economists, as a sudden bout of pessimism hammers financial markets, which on Thursday spiraled further from recent highs.

Although major swaths of the economy — including the job market and consumer spending — remain robust, there are mounting worries that rising borrowing costs for consumers and businesses, after years of near-zero interest rates, could cause a sudden retrenchment. The Federal Reserve has raised interest rates by 0.75 percentage points so far this year, while officials are signaling more aggressive increases could be necessary to cool the economy. Continued uncertainty from the coronavirus pandemic and Russia's invasion of Ukraine are adding to the uneasiness.

Financial markets fell again on Thursday, a day after the Dow Jones industrial average suffered its worst drop of the year. The S&P 500 inched further into bear market territory — defined as a 20 percent drop from the most recent peak — after Wednesday's sell-off wiped out more than 4 percent of its value.

"Recession risks are high — uncomfortably high — and rising," said Mark Zandi, chief economist at Moody's Analytics. "For the economy to navigate through without suffering a downturn, we need some very deft policymaking from the Fed and a bit of luck."

This week alone, former Goldman Sachs chief executive Lloyd Blankfein warned of a "very, very high risk" of recession; Wells Fargo CEO Charlie Scharf said there was "no question" that the U.S. economy is heading toward a downturn; and former Fed chair Ben Bernanke cautioned that the country could be poised for "stagflation" — a slowing economy combined with high inflation.

Those concerns come amid a smattering of data that points to economic cooling, particularly in interest-rate-sensitive sectors that are already feeling the brunt of the Fed's promise to keep tightening monetary conditions. New home construction slowed in April. Mortgage demand continues to decline.

Some of the country's largest and most influential retailers reported disappointing sales and profits this week because of higher costs and overstocked inventory issues, engineered to avoid supply chain disruptions, setting off a stock market meltdown. Walmart stock plunged more than 11 percent on Tuesday, its worst one-day loss in 35 years. On Wednesday, Target shares tumbled 26 percent, following a stunning 52 percent drop in quarterly profits, which executives attributed in part to cooling demand for big-ticket items such as TVs, kitchen appliances and outdoor furniture.

"While we anticipated a post-stimulus slowdown in these categories ... we didn't anticipate the magnitude of that shift," Brian Cornell, Target's chief executive, said in a Wednesday earnings call. "When we talk to our guests, they often express their concerns about a host of rapidly changing conditions, ranging from geopolitics to the high and persistent inflation they've been experiencing."

Goldman Sachs this week revised down its forecast for second-quarter U.S. economic growth, to an annualized rate of 2.5 percent, citing higher prices and continued supply chain disruptions. That follows an unexpected contraction in the first three months of 2022, when the economy shrank at a 1.4 percent pace, mostly because of a trade imbalance and a drop in inventory purchases.

International turmoil, including a risk of recession in Europe and China, is dimming the outlook for the U.S. economy. And a strengthening U.S. dollar — as rate increases make dollar investments more attractive — could dampen exports, raising the chances of a technical recession in which the economy contracts for two quarters in a row.

That fear of a souring economy as well as shifts in consumer pandemic spending habits have led some highflying tech darlings including Netflix and Peloton to announce layoffs in recent weeks. Twitter and Meta have paused hiring plans, while Amazon executives recently said the company was "overstaffed" after months of brisk hiring. National claims for unemployment insurance inched up to 218,000 last week, a four-month high although still near historic lows.

Meanwhile, inflation, which remains near 40-year highs, has become a central challenge for both the economy and the Biden administration. Higher prices for basics like food, energy and housing are straining Americans' budgets and clouding their view of the economy. Gas prices soared to yet another all-time high this week, with average prices hitting $4.57 per gallon nationwide. A closely watched consumer sentiment index by the University of Michigan shows that Americans' views of their current finances and future expectations have fallen sharply in the past year.

Despite that gloomy outlook, Americans continue to spend heartily. Sales of clothing, cars and furniture all ticked up in April, contributing to a 0.9 percent increase in overall retail sales from a month earlier, according to Commerce Department data released this week.

"Near term, the U.S. economy is holding up rather well despite the trouble abroad and the high prices at the checkout stand," said Beth Ann Bovino, chief U.S. economist for S&P Global, who says there's a 35 percent risk of recession in the next year. "People are spending, businesses are still trying to hire. But there are certainly challenges ahead. The Fed's actions will slow the economy, but the question is whether they could also topple the apple cart."

A day after warning that slower growth and inflation are "having stagflationary effects," Treasury Secretary Janet L. Yellen said Thursday she is optimistic the central bank could contain inflation without causing a recession. But she acknowledged that the ability to do so was far from clear.

"I think it's conceivable there could be a soft landing. It requires both skill and luck ... I hope that's the case, but this is a very difficult economic situation," Yellen told reporters in Germany, citing economic shocks from the war and sanctions on Russia. "There's a lot going on. ... It's not a straightforward matter."

Even if the United States staves off a recession in the short term, some economists say the sheer pace of inflation, with prices up 8.3 percent in the past year, and the persistent supply-and-demand imbalances caused by the pandemic, and the policy responses to it, could snowball into an even more severe crisis down the line.

"Consumers are spending like crazy, businesses are going to need to rebuild their inventories, and a lot of workers are still flowing back into the labor market," said Jason Furman, an economics professor at Harvard University who served as an adviser during the Obama administration. "But all of this makes me worry about one or two or three years from now — because it might mean the Fed needs to raise rates even more, and it might mean you create an even bigger recession later."

Zandi, of Moody's, said rising gas and commodity prices from pandemic-related supply chain snarls and the conflict in Ukraine have added to the specter of an economic downturn. He now puts the odds of a U.S. recession in the next 24 months at about 50 percent.

"We're traveling very close to the edge," he said. "The housing market is the next thing that's going to roll over; the question is just how hard."

New home construction fell in April, led by a slowdown in single-family homes. Building permits, which offer a glimpse into future construction, also declined, according to data released this week by the Census Bureau and the Department of Housing and Urban Development.

"Home builder sentiment fell to the lowest level in two years in May," Yelena Maleyev, an economist for Grant Thornton, said in an analyst note. "Builders are seeing less foot traffic and expect sales to be softer as we enter the busy home-buying season."

That softening is already rippling through the economy. Major mortgage lenders across the country, including Wells Fargo and Better.com, have laid off thousands in recent weeks as a result of dwindling demand for home loans and refinancing.

In Alexandria, Va., mortgage lender Kevin Retcher said there is a discernible skittishness among potential home buyers. Refinances began tumbling late last year, around the time the Fed began signaling upcoming rate increases. In the months since, a combination of rising mortgage rates — now at 5.3 percent for a fixed-rate 30-year mortgage, nearly double early 2021 levels — and sky-high home prices have begun deterring buyers, he said. At least three clients have gotten "cold feet" and pulled out of ratified contracts in the past two weeks, he added.

"There is an extreme sense of nervousness out there," said Retcher, president of First Meridian Mortgage. "It's rare to have people win contracts and then back out, but that's what's been happening."

Other types of small businesses say they're seeing a pullback in consumer demand, too, as customers grapple with rising costs. Aaron Mulherin, who owns a glass repair company in Marion, Iowa, said that while homeowners are continuing to pay for necessities such as fixing broken windows, they're starting to think twice about spending on luxuries such as custom showers.

"Average, middle-class consumers are starting to hesitate," Mulherin said. "Everything is getting more expensive, so they're getting an estimate, then putting it off."

Jeff Stein and Taylor Telford contributed to this report