The economy will grow this year and next, but with some storm clouds in the future. Inflation will remain a problem for at least two years, with rising interest rates eventually dampening demand for goods and services. The risk of recession is low this year but will rise significantly in late 2023 and beyond.

Despite a small drop in gross domestic product in the first quarter of this year, demand is strong across the economy. Consumers received massive stimulus during the pandemic, much of which they are now ready to spend.

Businesses are ordering more computers, machinery and equipment. We used to worry that robots would take jobs, but now we hope they will fill empty seats.

Construction is booming but the housing market will cool off due to rising mortgage rates and inflation dampening consumer finances. This will be a correction, not a bust. Nonresidential construction will grow, especially of factories, and in later years infrastructure.

Adding all parts of the economy together, demand this year and next will be greater than our ability to produce goods and services.

That limitation on production is mostly labor. Hiring will become a little easier as Covid plays a lesser role in people’s decisions, as schools are open more reliably, and as stimulus and unemployment payments are farther in the past.

However, recall that the labor market was very tight in January 2020 before the coronavirus. The challenge of hiring workers will go from bizarrely difficult to just moderately hard this year. Other supply issues, such as factory capacity, will slowly improve, but look for a bit of a clogging up of ports when Chinese production resumes after Covid lockdowns.

With demand stronger than our ability to produce goods and services, inflation will remain a problem. The U.S. Treasury and the Federal Reserve both figured that they would rather risk over-stimulus than under-stimulus, an understandable choice given the murkiness of the economic outlook in the pandemic. Now we are paying higher prices.
The Fed will likely push short-term interest rates up over the next two years. Long-term interest rates have already risen as traders anticipate continued Fed tightening.

Efforts to fight inflation in the past have sometimes caused recessions. It’s too early to say for sure that is our future, but the Fed was late tightening. Now they need both skill and luck to avoid a downturn. The Ukraine war is a negative, of course, but the Fed’s luck could improve. The economy looks secure in 2022 and early 2023, but after that the risk of a recession rises significantly.

It’s too early for most businesses to hunker down and conserve cash, but planning for that possibility will help companies survive if a recession does come. Economies with low inflation, as we had for decades, tend to have milder business cycles than economies with high inflation—and that’s us right now. So get ready for a wild ride in the years ahead.

The economies of Washington and Oregon are growing faster than the national economy although they have been slower to recover their pandemic job losses. Washington state employment is growing solidly but remains 1.2 percent below pre-pandemic levels, while Oregon is 1.8 percent below. The nation is closer to full recovery, 0.8 percent below past highs. Both states were slower to recover due to more cautious Covid behavior, both in terms of regulation and voluntary behavior.

Pacific Northwest population continues to grow faster than in the nation. Strong incomes have resulted from both employment growth and wage gains, putting income growth above inflation in both Washington and Oregon. This is in contrast with the nation, where inflation is higher than income gains.

The continued population growth fuels the housing market, pushing home prices up about 20 percent in both states. Here as in the nation homebuilding pushes up against the limits of lot availability, labor and materials supply. The housing market in our region won’t falter like the national market thanks to higher income growth and population growth.

At some point in the future our high housing costs may limit further migration into the region, slowing economic growth rates. That time is uncertain but is a risk to long-term economic growth.

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