Economic and Industry Perspectives: Outlook for US and Illinois in 2021

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2020, a year of uncertainty

Initial assessment of the impact of the pandemic suggested a severe recession. Projections of more than 6% decline in GDP for the year.

The most pessimistic forecasts failed to appear. Why?

- Key portions of the economy managed to maintain output by adapting production. Manufacturing found ways to keep people safe on the production line, while work from home/telecommuting kept business and professional services going.
- Still, evidence suggests a K shaped recovery. While the decline in aggregate economic output was less than feared, certain sectors of the economy such as brick and mortar retail, restaurants, hotels and entertainment were slammed.
- Government policy helped mute impact on economy. CARES act and other measures pumped money into the economy bolstering consumption. Fed policy of essentially zero rate interest rates supported borrowing and the housing market.
- What else helped? Job losses were more heavily concentrated across lower wage workers, stock market surge
- Bottom line, while health impacts have been severe, economic impacts while uneven have been buffered.

What about 2021?

First and foremost the path of the pandemic will dictate the shape of recovery in 2021.

Early estimates suggest that with a vaccine becoming widely available in the second half of 2021, the economy will experience a strong snapback as pent-up demand is released (and supported by high levels of personal savings) and public-facing sectors of the economy gradually return to normal (travel, restaurants and entertainment start to return)

The big question—will COVID alter future economic activity? Did the pandemic pull forward certain economic trends and what will that mean for future growth?

Outlook according to December FOMC

December FOMC Continued Trend Toward Improved Outlook

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, December 2020

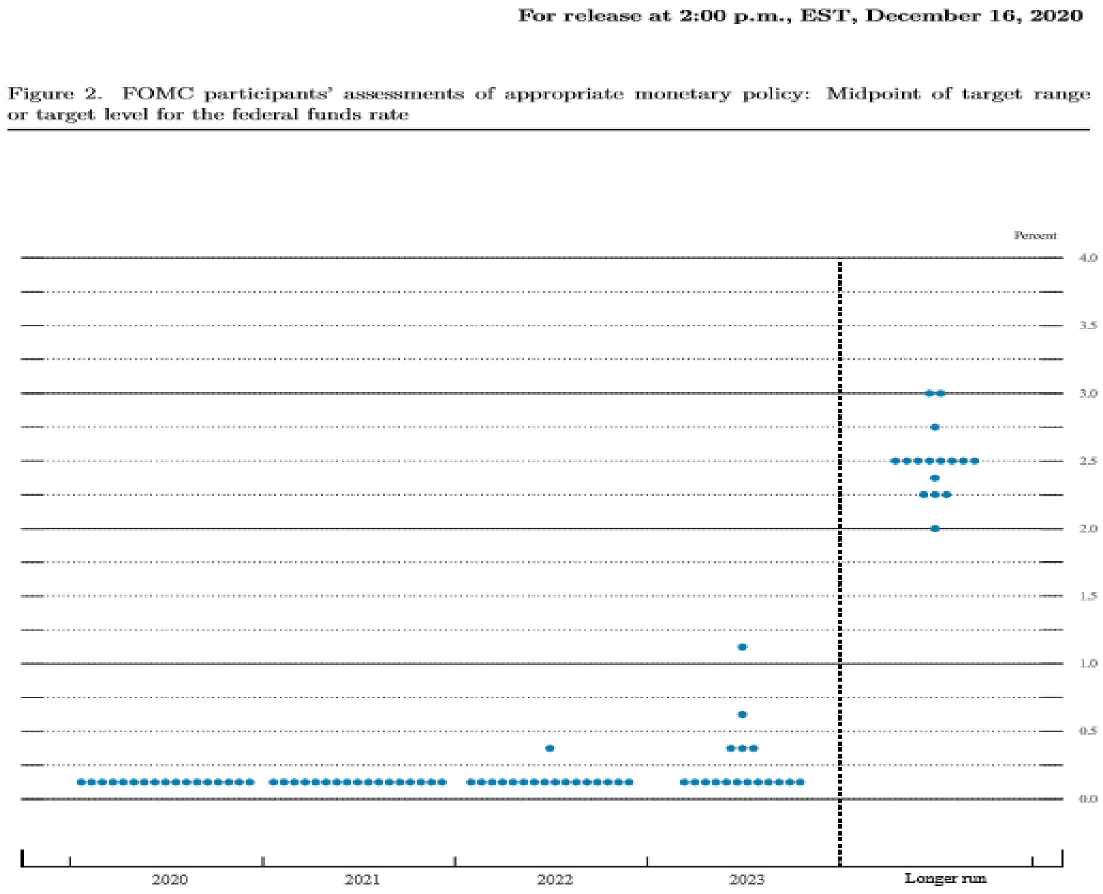
Percent

Variable	Median[1]					Central Tendency[2]					Range[3]				
	2020	2021	2022	2023	Longer run	2020	2021	2022	2023	Longer run	2020	2021	2022	2023	Longer run
Change in real GDP	-2.4	4.2	3.2	2.4	1.8	-2.5–-2.2	3.7–5.0	3.0–3.5	2.2–2.7	1.7–2.0	-3.3–-1.0	0.5–5.5	2.5–4.0	2.0–3.5	1.6–2.2
September projection	-3.7	4.0	3.0	2.5	1.9	-4.0–-3.0	3.6–4.7	2.5–3.3	2.4–3.0	1.7–2.0	-5.5–1.0	0.0–5.5	2.0–4.5	2.0–4.0	1.6–2.2
Unemployment rate	6.7	5.0	4.2	3.7	4.1	6.7–6.8	4.7–5.4	3.8–4.6	3.5–4.3	3.9–4.3	6.6–6.9	4.0–6.8	3.5–5.8	3.3–5.0	3.5–4.5
September projection	7.6	5.5	4.6	4.0	4.1	7.0–8.0	5.0–6.2	4.0–5.0	3.5–4.4	3.9–4.3	6.5–8.0	4.0–8.0	3.5–7.5	3.5–6.0	3.5–4.7
PCE inflation	1.2	1.8	1.9	2.0	2.0	1.2	1.7–1.9	1.8–2.0	1.9–2.1	2.0	1.1–1.4	1.2–2.3	1.5–2.2	1.7–2.2	2.0
September projection	1.2	1.7	1.8	2.0	2.0	1.1–1.3	1.6–1.9	1.7–1.9	1.9–2.0	2.0	1.0–1.5	1.3–2.4	1.5–2.2	1.7–2.1	2.0
Core PCE inflation[4]	1.4	1.8	1.9	2.0		1.4	1.7–1.8	1.8–2.0	1.9–2.1		1.3–1.5	1.5–2.3	1.6–2.2	1.7–2.2	
September projection	1.5	1.7	1.8	2.0		1.3–1.5	1.6–1.8	1.7–1.9	1.9–2.0		1.2–1.6	1.5–2.4	1.6–2.2	1.7–2.1	
Memo: Projected appropriate policy path															
Federal funds rate	0.1	0.1	0.1	0.1	2.5	0.1	0.1	0.1	0.1–0.4	2.3–2.5	0.1	0.1	0.1–0.4	0.1–1.1	2.0–3.0
September projection	0.1	0.1	0.1	0.1	2.5	0.1	0.1	0.1	0.1–0.4	2.3–2.5	0.1	0.1	0.1–0.6	0.1–1.4	2.0–3.0

NOTE: Projections of change in real gross domestic product (GDP) and projections for both measures of inflation are percent changes from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The projections for the federal funds rate are the value of the midpoint of the projected appropriate target range for the federal funds rate or the projected appropriate target level for the federal funds rate at the end of the specified calendar year or over the longer run. The September projections were made in conjunction with the meeting of the Federal Open Market Committee on September 15–16, 2020. One participant did not submit longer-run projections for the change in real GDP, the unemployment rate, or the federal funds rate in conjunction with the September 15–16, 2020, meeting, and one participant did not submit such projections in conjunction with the December 15–16, 2020, meeting.

1. For each period, the median is the middle projection when the projections are arranged from lowest to highest. When the number of projections is even, the median is the average of the two middle projections.
2. The central tendency excludes the three highest and three lowest projections for each variable in each year.
3. The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.
4. Longer-run projections for core PCE inflation are not collected.

Current Expectation That Rates Will Remain Near Zero Through 2023



Fed Has Issued a Revised Monetary Policy Stance

Basic premise is keep rates low for longer even when recovery is underway. Recognition that lowering the Fed funds rate has limitations in a low inflation world.

Allow inflation to run above the 2% target for a period to achieve an average rate of inflation of 2%.

"The September statement specifies that we will maintain the current 0 to 1/4 percent target range for the federal funds rate until we have reached our employment mandate and inflation has reached 2 percent and is on track to moderately exceed 2 percent for some time."

"For the sake of argument, here are a couple of simple calculations that illustrate how long it might take to achieve our 2 percent average inflation target. Forget the many years since 2008 of underrunning our 2 percent inflation target, and let's just calculate the average beginning with the price level in the first quarter of 2020. Core PCE inflation in the SEP is projected to be 1-1/2 percent this year and then gradually rise to 2 percent in 2023.[12] Suppose it hits 2-1/4 percent in 2024 and then remains there. In this scenario, average core inflation does not reach 2 percent until mid-2026. That is a long time. If inflation were a bit higher—say, 2-1/2 percent in 2024 and beyond—you can get there about a year quicker. Some, though, might view 2-1/2 percent inflation as an excessive overshoot."

—Charles Evans, President, Federal Reserve Bank of Chicago 10/7/20.

COVID and the Economy

Labor Markets

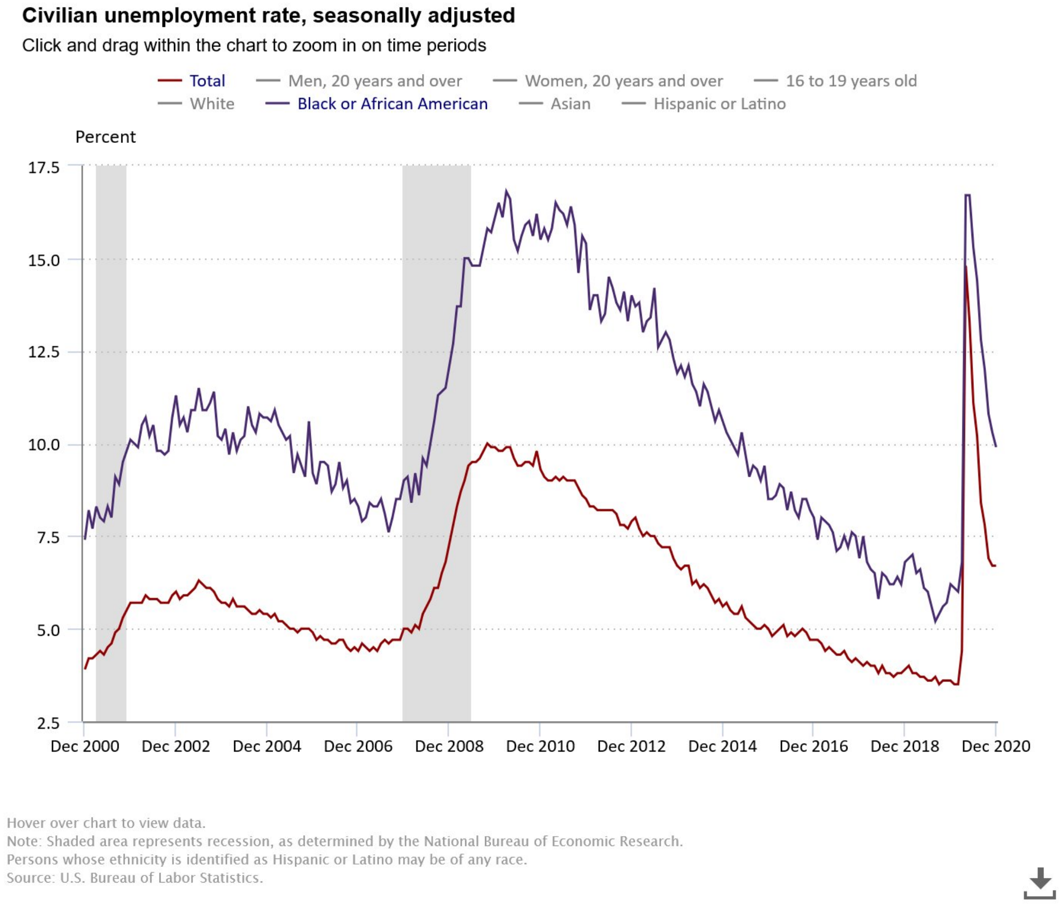
Real Estate—housing strong/retail and commercial real estate weak

Personal Savings

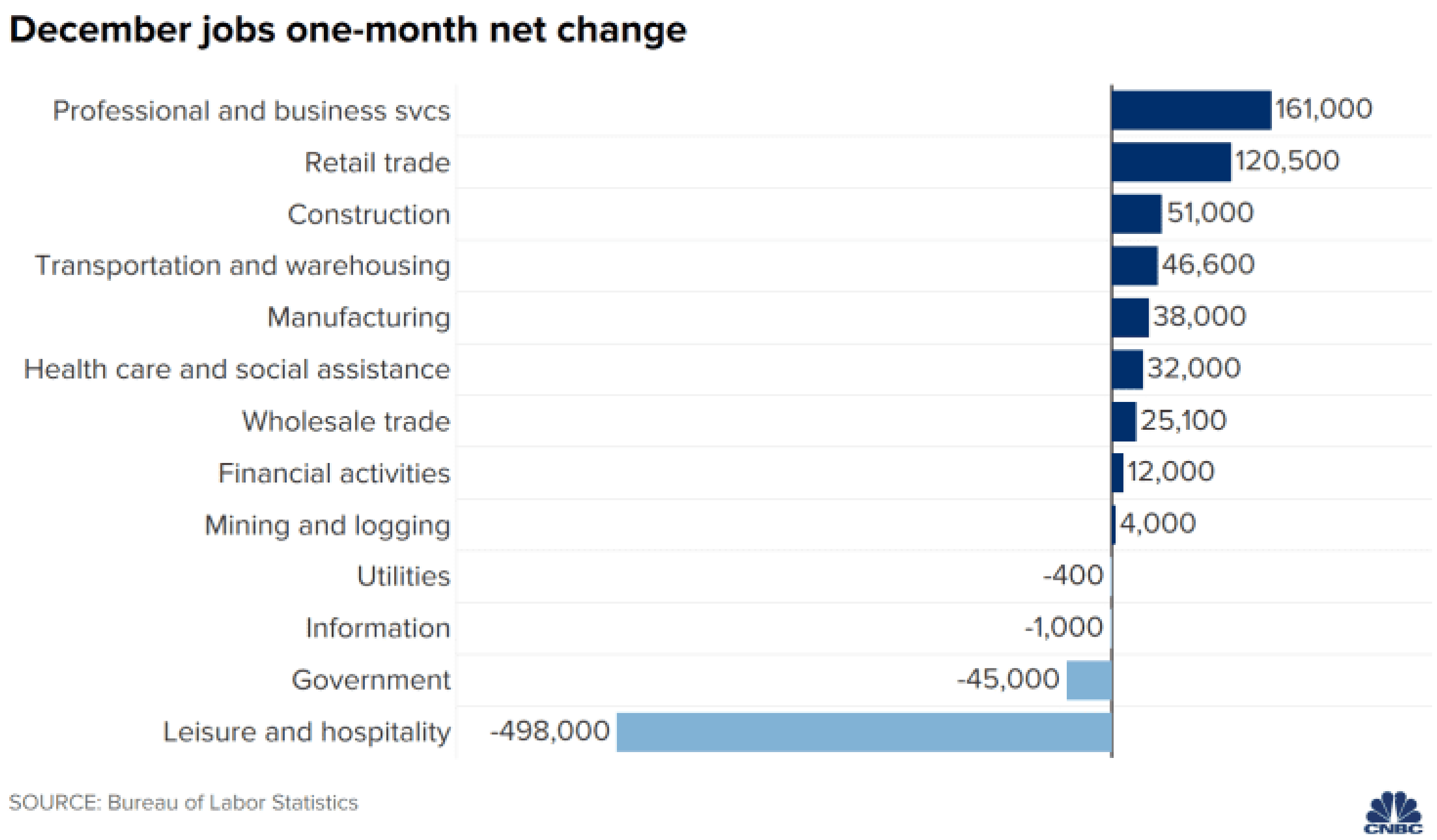
Stock Market

Appears to have pulled certain trends (technology, e-commerce, remote work) forward

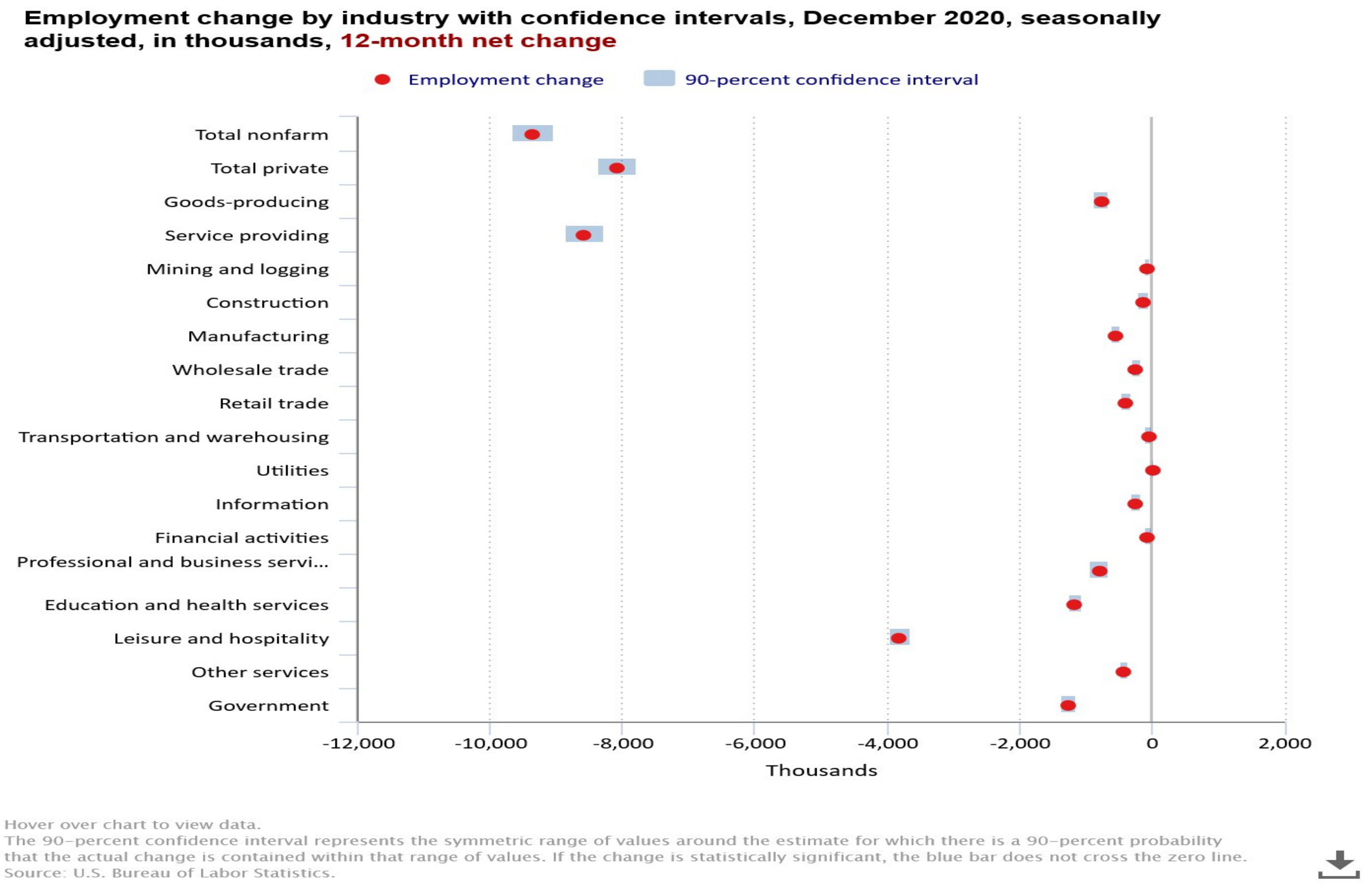
December Labor Report Shows Impacts of Virus Resurgence/Lockdowns-- Employment drops by -140,000, Unemployment rate much higher for blacks



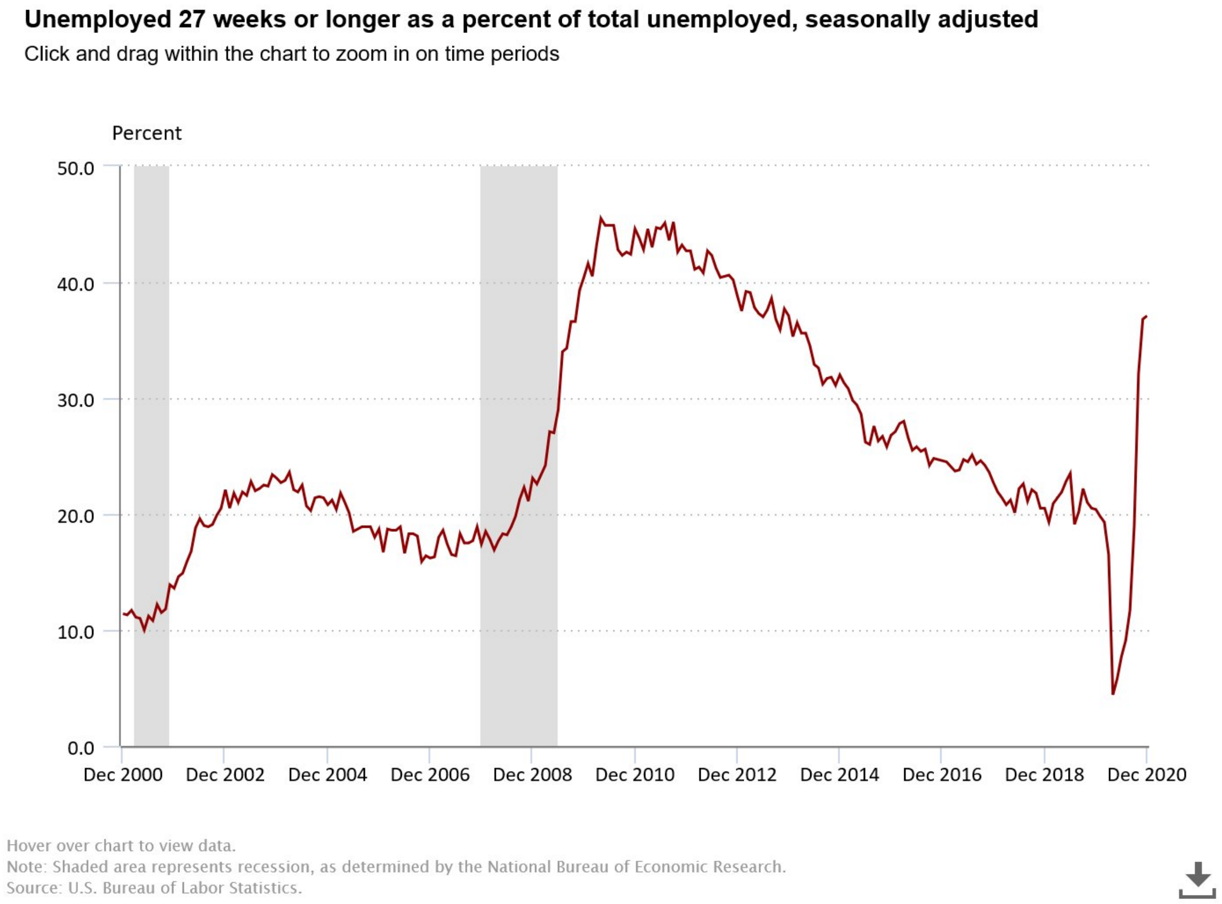
December Employment Report—evidence of where case spike is being felt



Job losses are across almost all industries but particularly Services, Leisure and Hospitality and Government—12 month change

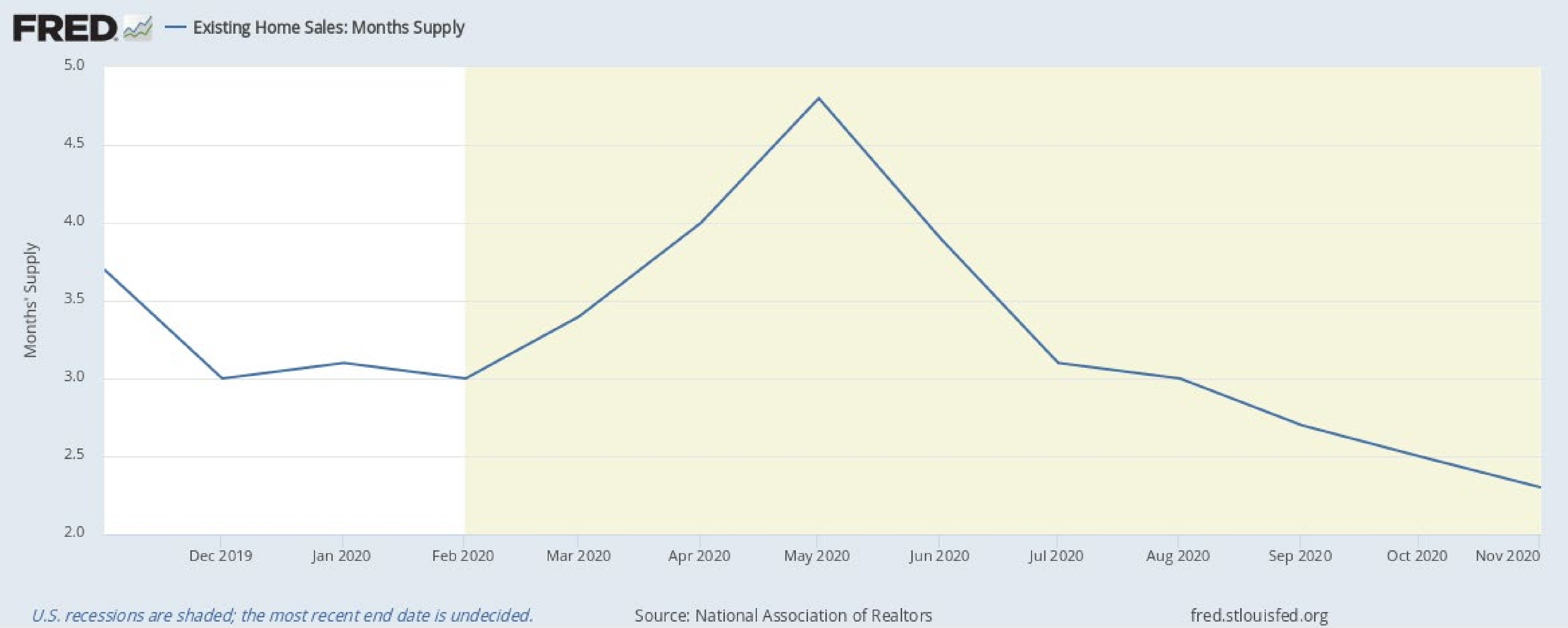


A Big Concern—more layoffs appear to be long-term



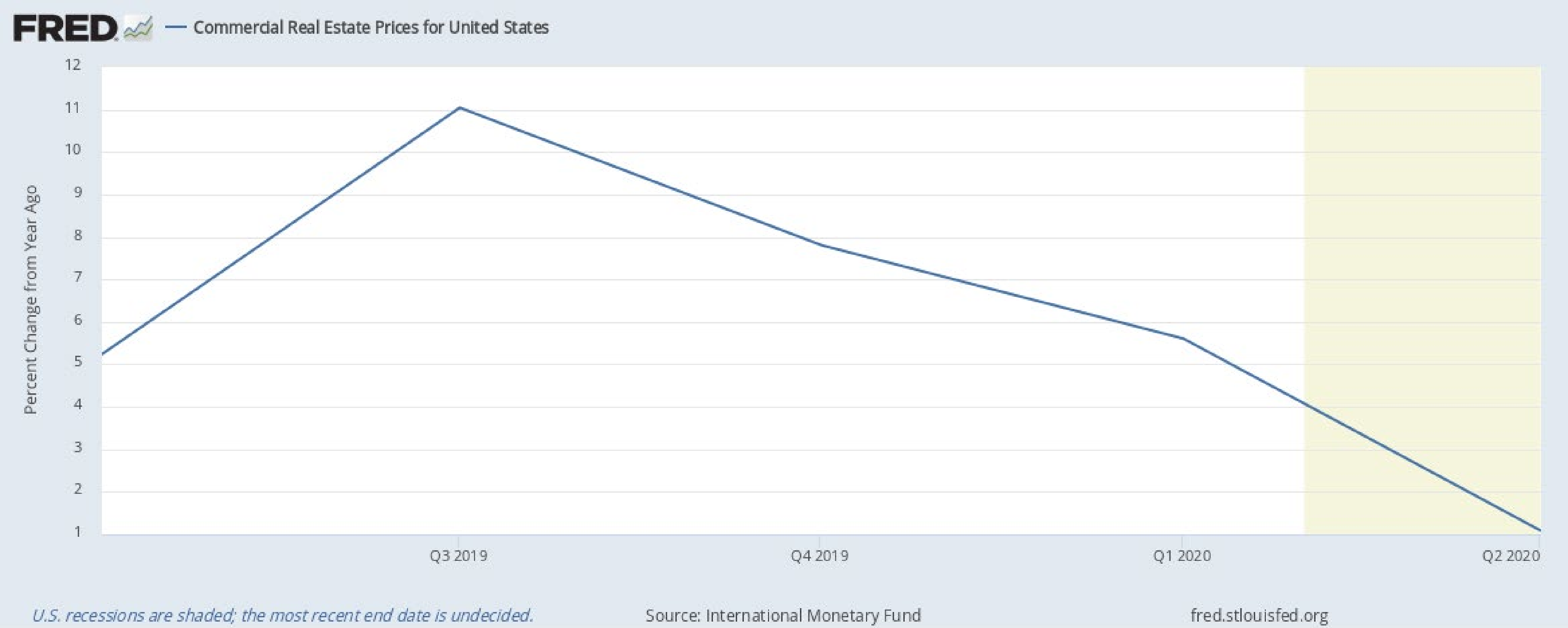
Home sales surge during the Summer and stay strong in the Fall

Inventory may be holding back an even bigger boom in housing

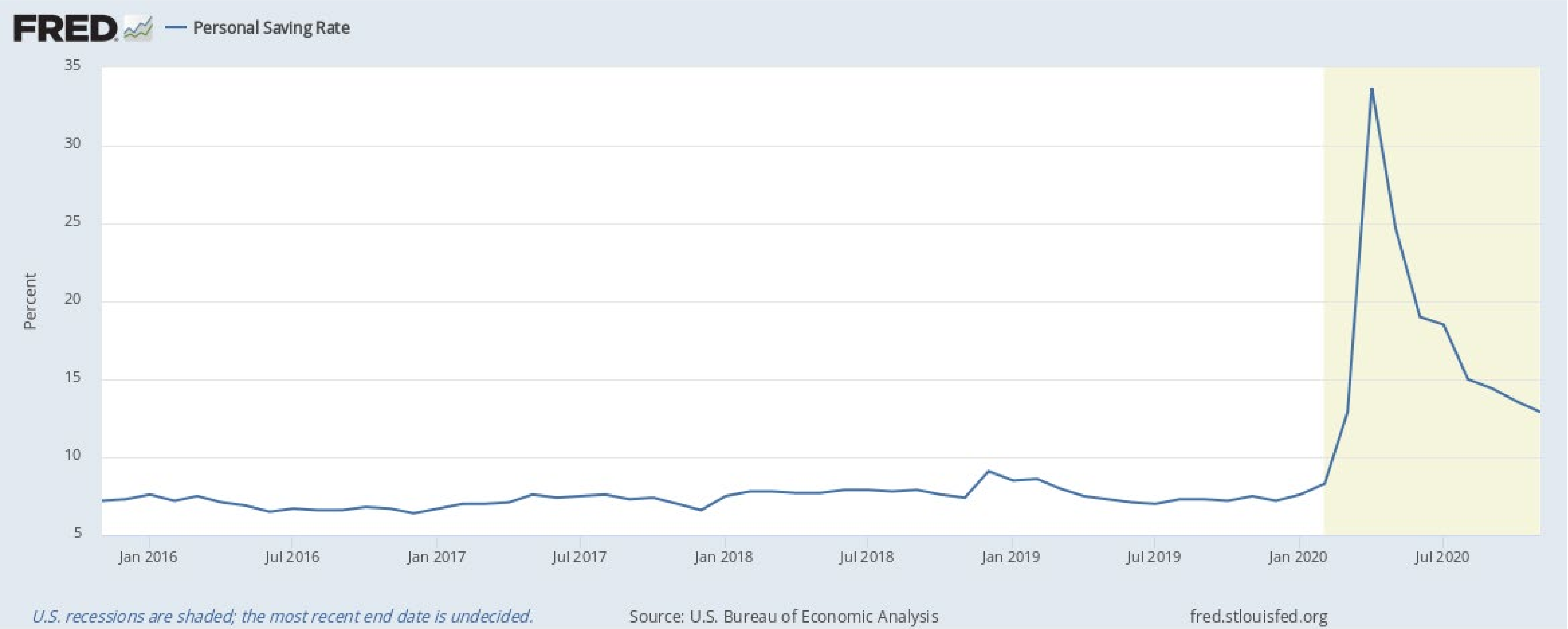


Combination of surging sales and tight inventory pushes up housing prices

Commercial Real Estate Prices Under Pressure

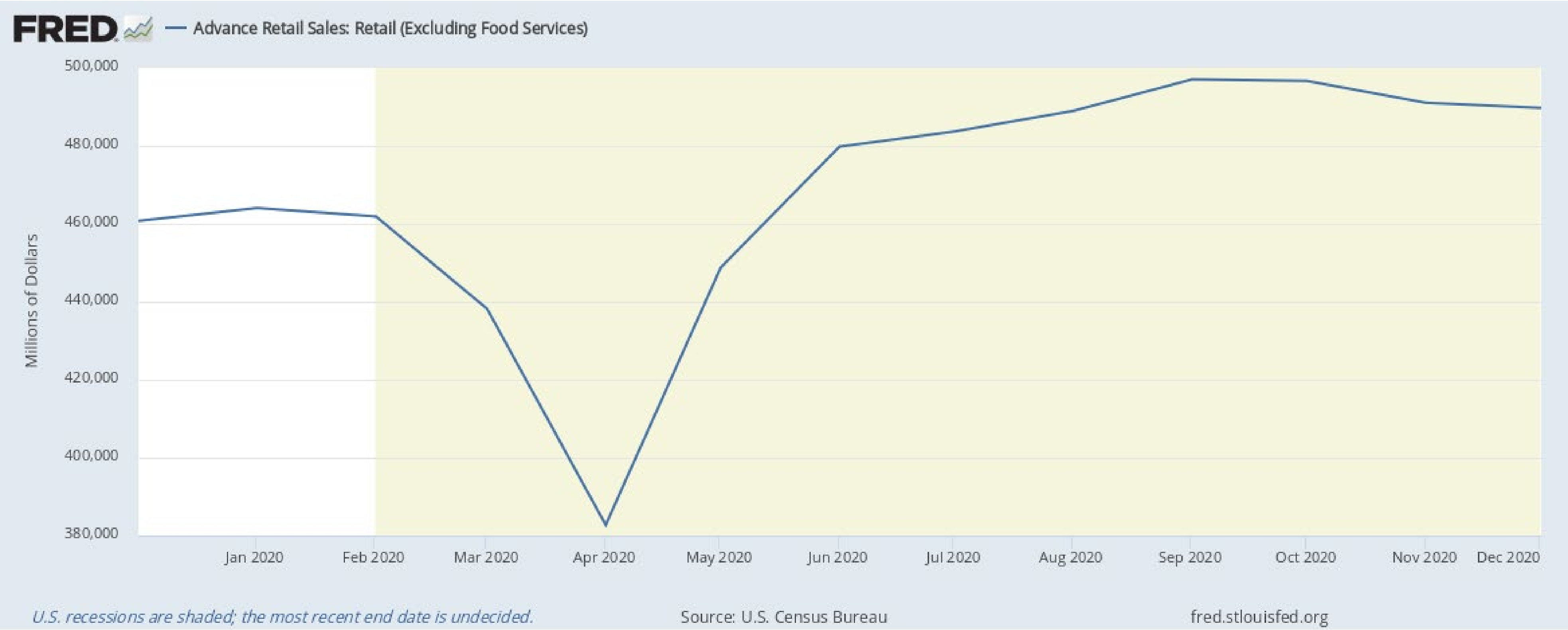


Personal Savings--November was still 12.9%



Stocks have been on a run since end of March

Rebound in retail sales was quite sharp with sales levels above pre-pandemic levels although holiday sales were less than expected



Recent surge in COVID cases has weakened retail sales except in certain categories

Name	Percent Change from Preceding Period		
	Dec 2020	Nov 2020	Dec 2019
Retail Trade and Food Services	-0.7	-1.4	0.1
Retail Trade and Food Services, ex Auto	-1.4	-1.3	0.6
Retail Trade	-0.3	-1.1	-0.1
Motor Vehicle and Parts Dealers	1.9	-1.5	-2.0
Auto and Other Motor Vehicles	2.0	-1.6	-2.1
Furniture and Home Furnishings Stores	-0.6	-2.1	-1.4
Electronics and Appliance Stores	-4.9	-8.3	0.4
Building Material and Garden Equipment and Supplies Dealers	0.9	0.8	1.7
Food and Beverage Stores	-1.4	1.5	0.3
Grocery Stores	-1.7	1.6	0.3
Health and Personal Care Stores	1.1	-0.4	-0.5
Gasoline Stations	6.6	-1.6	1.6
Clothing and Clothing Access. Stores	2.4	-6.1	2.8
Sporting Goods, Hobby, Book, and Music Stores	-0.8	-1.7	1.7
General Merchandise Stores	-1.2	-1.3	0.4
Department Stores	-3.8	-7.6	-0.8
Miscellaneous Store Retailers	1.7	-0.1	-1.2
Nonstore Retailers	-5.8	-1.6	-0.2
Food Services and Drinking Places	-4.5	-3.6	1.0

Composition of retail sales changed

Purchases of goods grows sharply. People invest in their homes, buy electronics, exercise equipment.

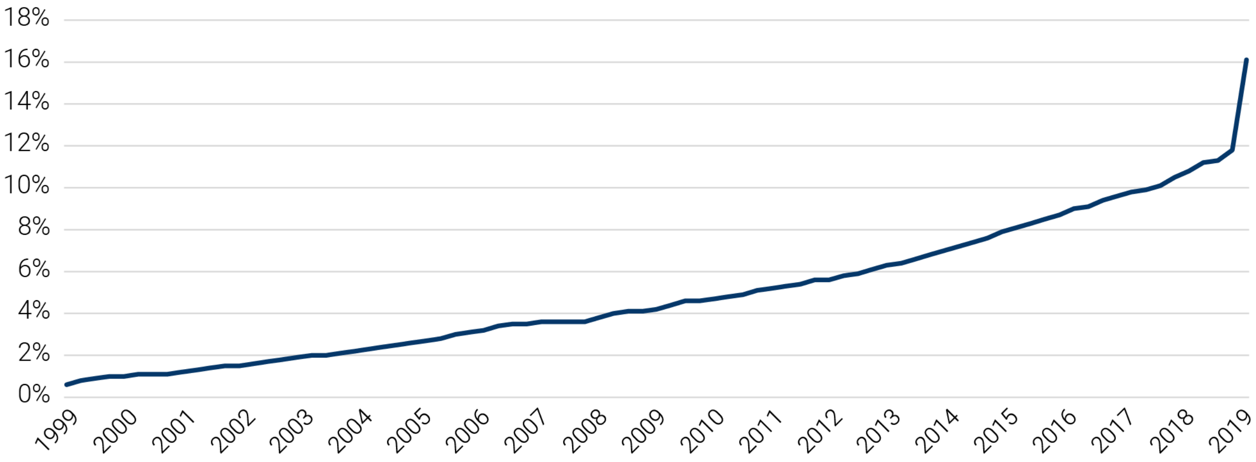
Sales of services falls. Dining and entertainment options are limited, travel is constrained.

How people shop also changes…

E-Commerce spike—will it continue?

Figure 1. E-commerce retail sales as a percent of total sales

Q4 1999 to Q2 2020



Source: Brookings analysis of Census Bureau data.

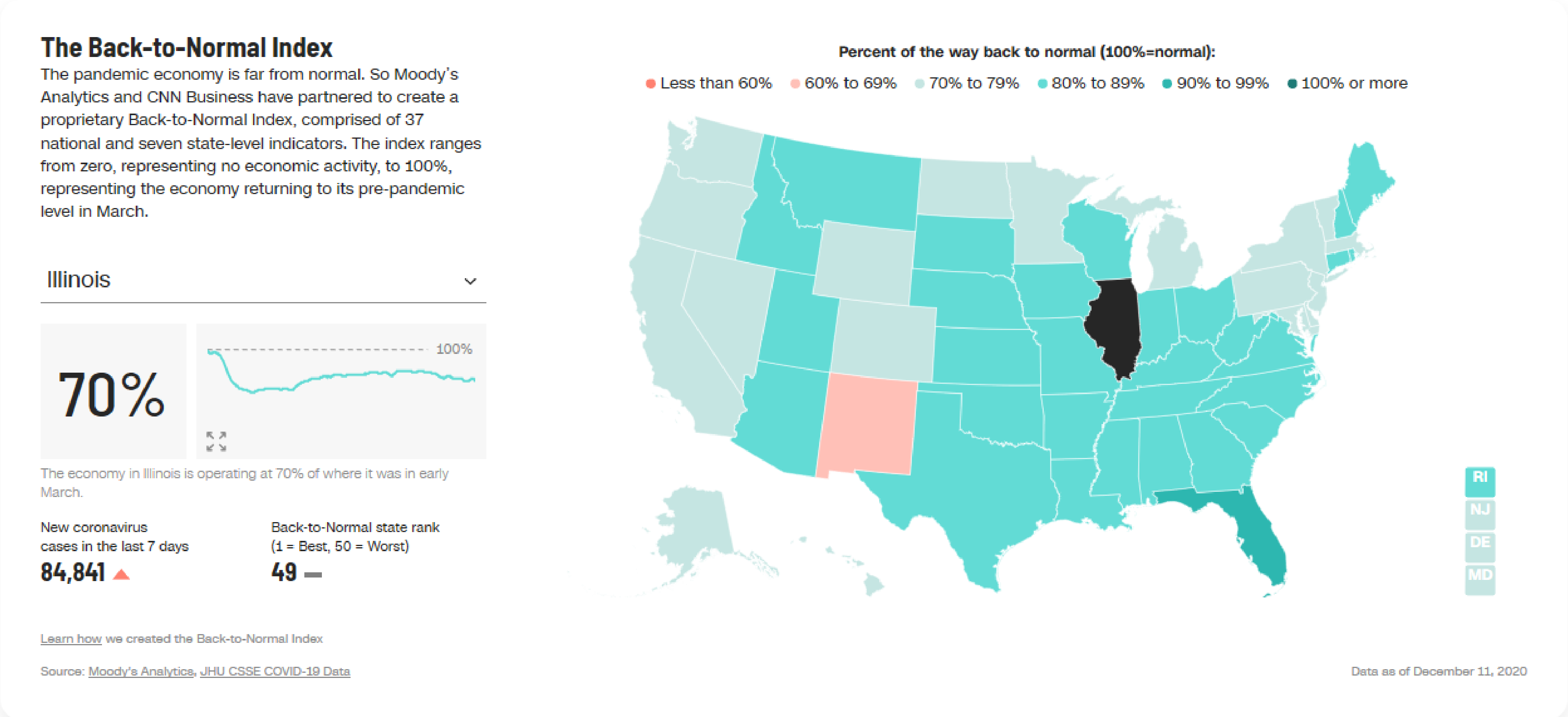
B | Metropolitan Policy Program at BROOKINGS

Turning to Illinois

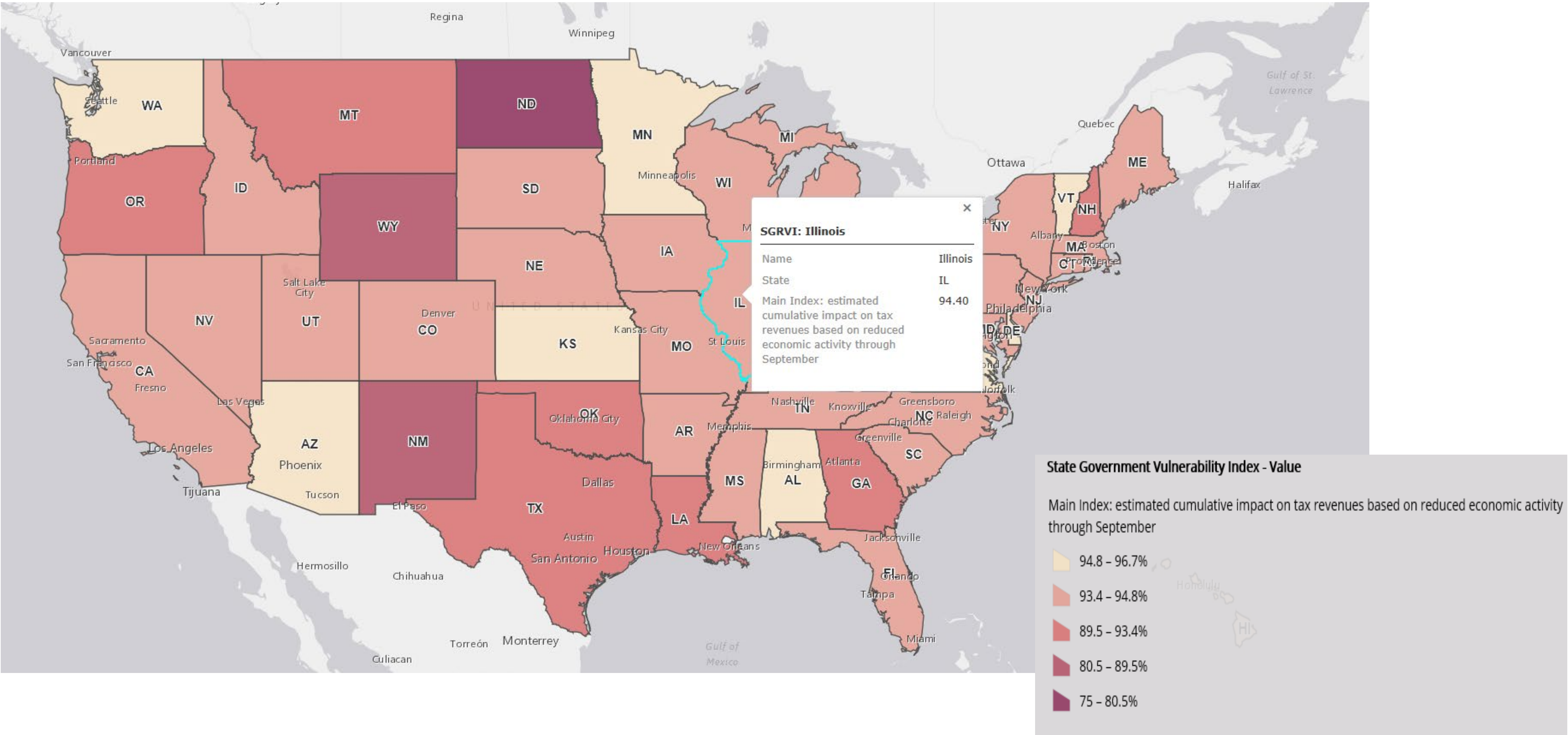
Uneven impact of the pandemic on the economy and communities mirrors US experience

- Indicators of impact—
  - *Fiscal conditions—tax revenue*
  - *Employment*
  - *Impacts based on differing industries, income levels*

Moody’s/CNN Back to Normal Index

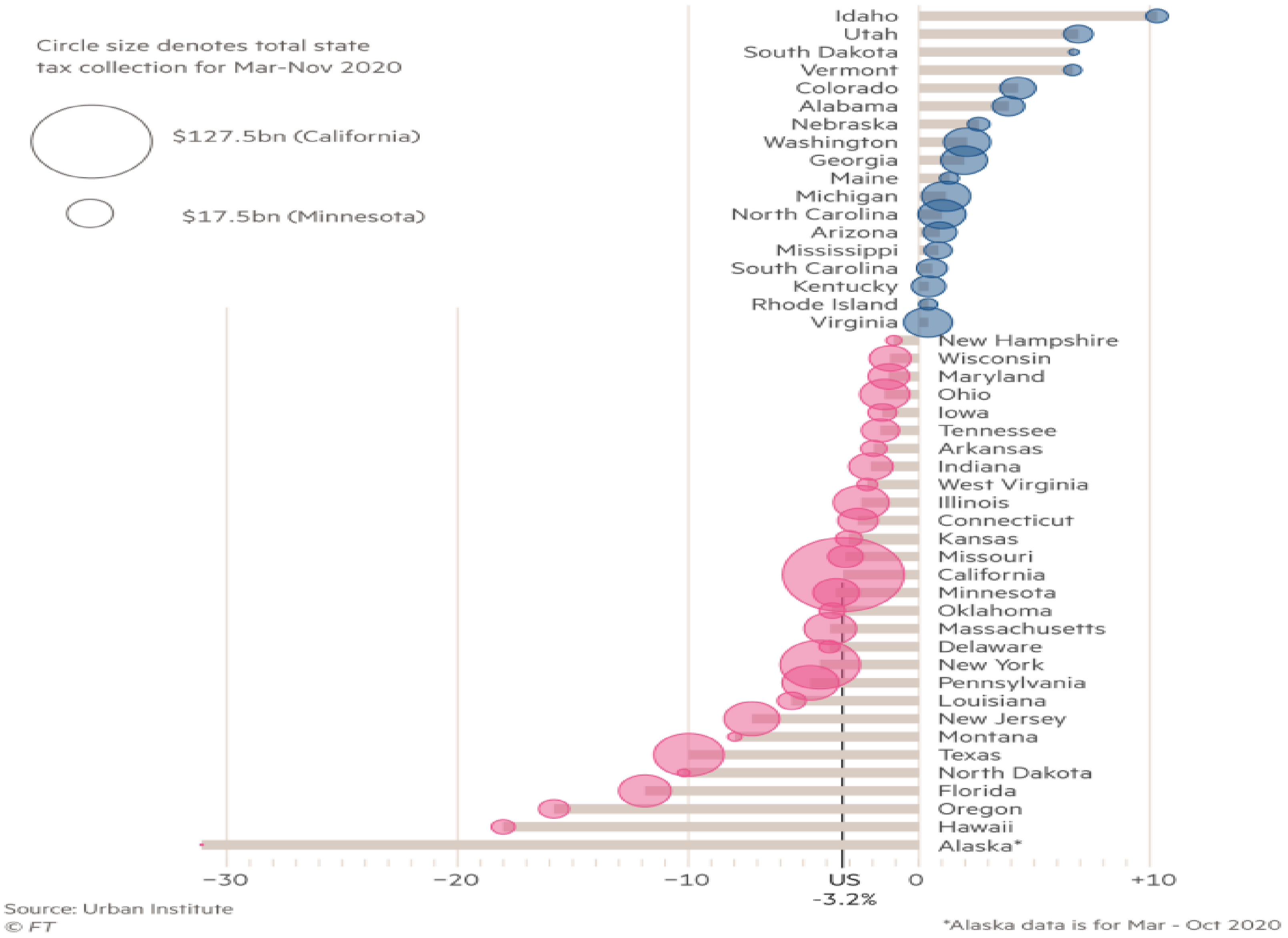


Argonne National Labs—tax revenue vulnerability



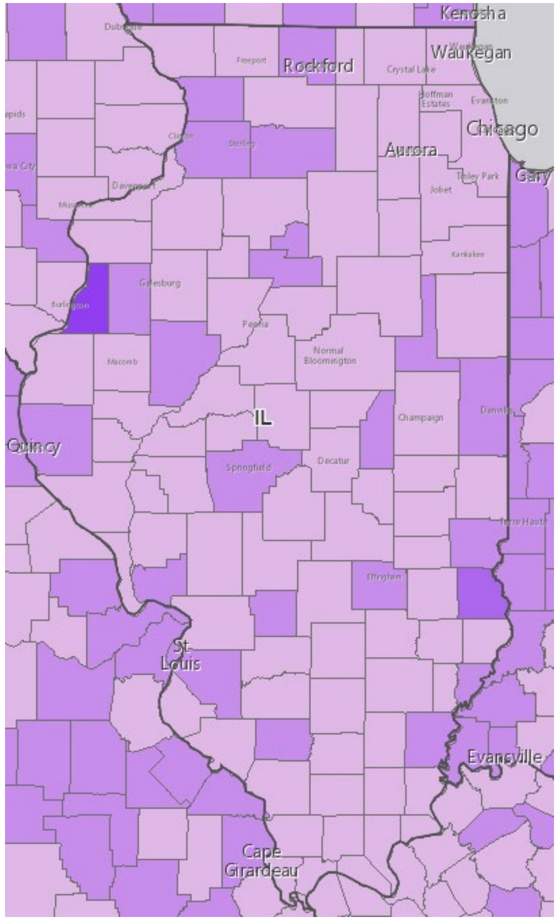
More losers than winners: state tax revenues battered by pandemic

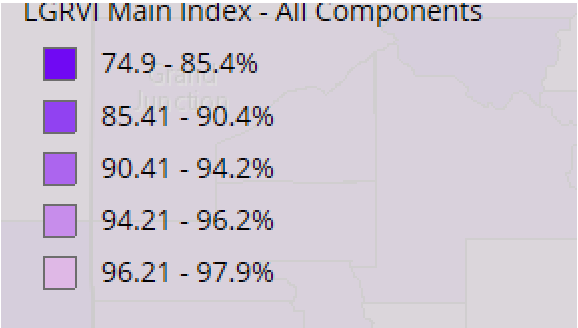
State tax collections for March-November 2020, compared to the prior period (%)



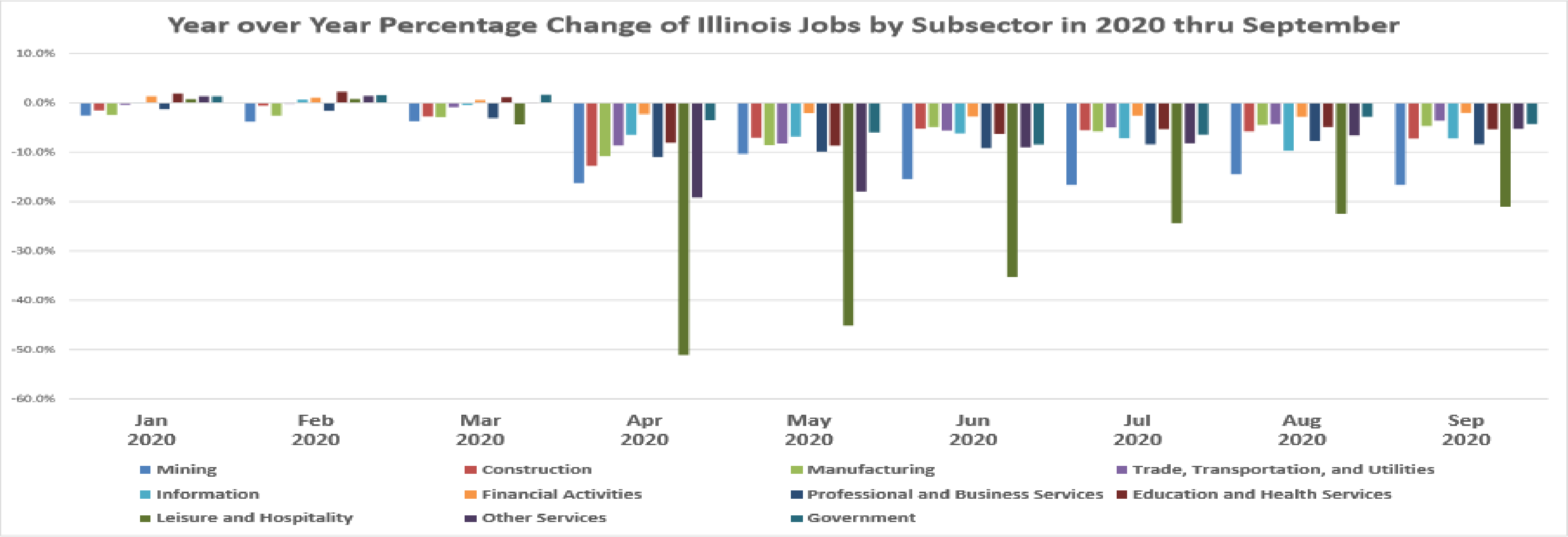
Source: Urban Institute

Argonne National Labs—Local Government Revenue Vulnerability by County





DECLINE IN ILLINOIS JOBS



The graph above displays the immediate impact that the COVID-19 pandemic had on Illinois jobs, starting in April 2020. It also shows how the falloff has slowly improved from its initial decline, but still remains well below levels from a year prior.

Also shown is the variance in the levels of declines by subsector. Here, the drastic impact on job levels in the lower-paying "Leisure and Hospitality" subsector can clearly be seen. In September 2020, jobs in this subsector made up 8.6% of total Illinois jobs. However, 31.7% of the lost jobs (as compared to a year ago) came from this sector of employment.

Source: Commission on Government Forecasting and Accountability. "November 2020 Updated Economic and FY 21 Revenue Outlook".

Uneven Impact of COVID Shows Up In Year-end Data

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS*	LATEST MONTH	PRIOR MONTH	A YEAR AGO
Unemployment Rate (Average) (Nov.)	6.9%	7.4%	3.7%
Inflation in Chicago (12-month percent change) (Nov.)	0.8%	1.0%	2.2%

	LATEST MONTH	CHANGE OVER PRIOR MONTH	CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (Nov.)	6,138.1	-2.4%	0.0%
Employment (thousands) (Nov.)	5,712.1	-1.9%	-7.8%
Nonfarm Payroll Employment (Nov.)	5,692,600	-20,000	-412,600
New Car & Truck Registration (Nov.)	37,203	-19.1%	-13.3%
Single Family Housing Permits (Nov.)	776	-22.0%	17.8%
Total Exports ($ mil) (Oct.)	5,004.8	10.4%	-3.4%
Chicago Purchasing Managers Index (Dec.)	59.5	2.2%	21.7%

* Due to monthly fluctuations, trend best shown by % change from a year ago

Source: Commission on Government Forecasting and Accountability, "Monthly Briefing for the Month Ended: December 2020"

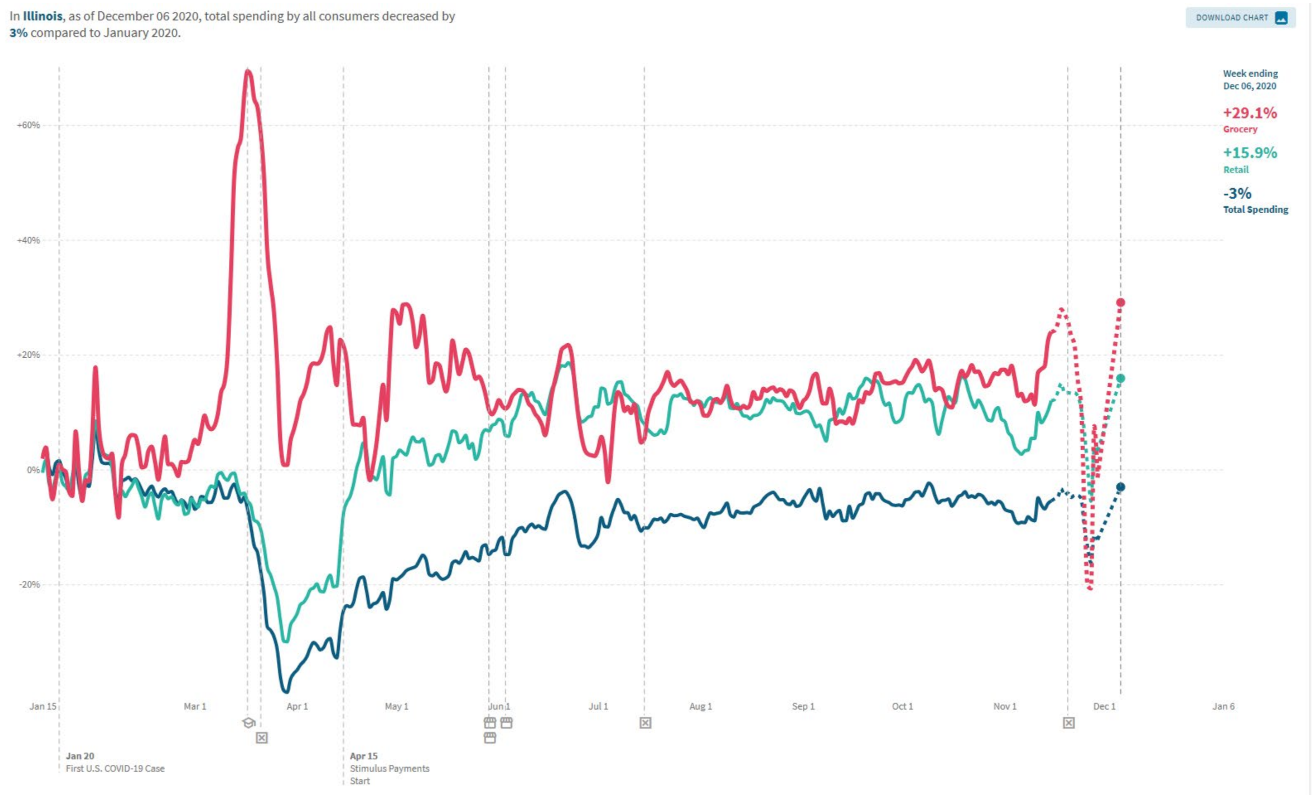
Turning to Illinois, data from the Opportunity Insights Economic Tracker

OPPORTUNITY INSIGHTS
ECONOMIC TRACKER

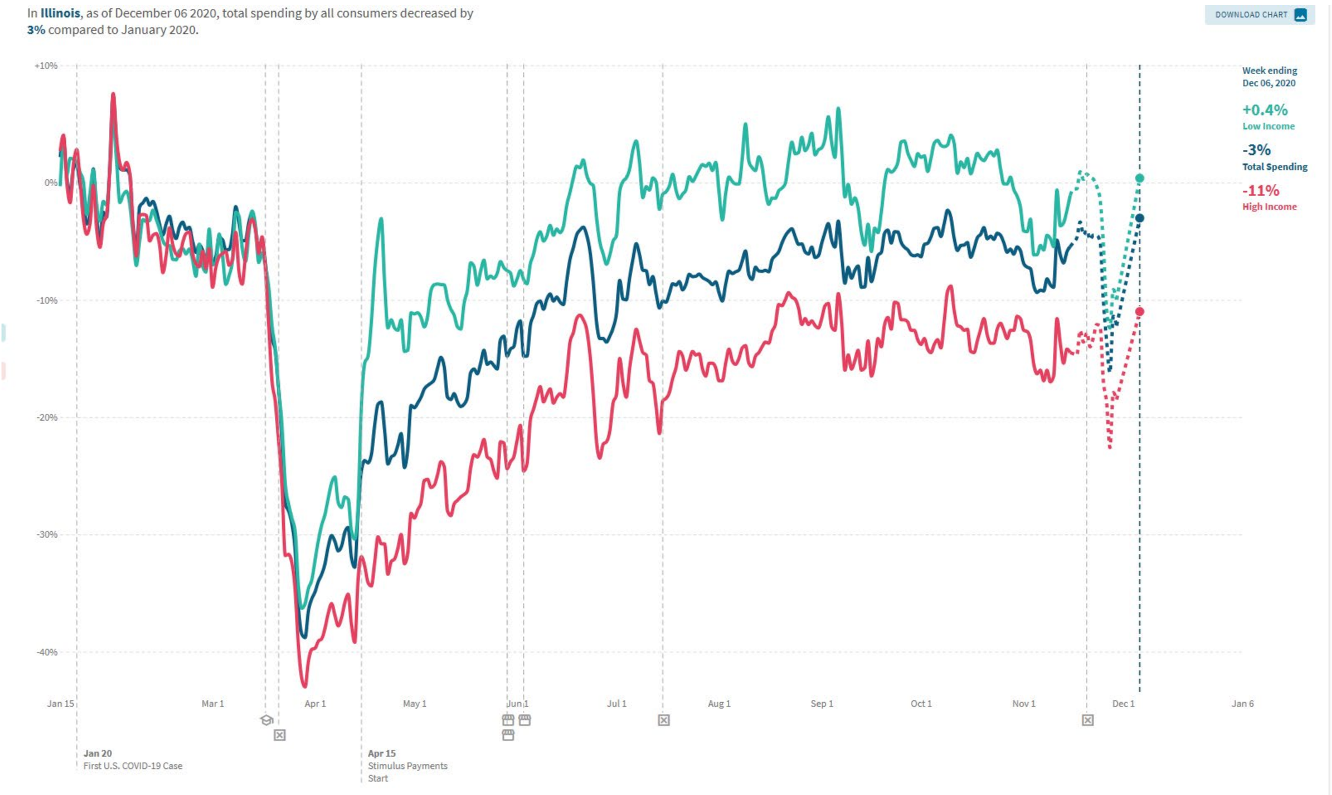
Track the economic impacts of COVID-19 on people, businesses, and communities across the United States in real time.

The Economic Impacts of COVID-19: Evidence from a New Public Database Built Using Private Sector Data *
Raj Chetty, John N. Friedman, Nathaniel Hendren, Michael Stepner, and the Opportunity Insights Team
First Version: May 2020 This Version: November 2020

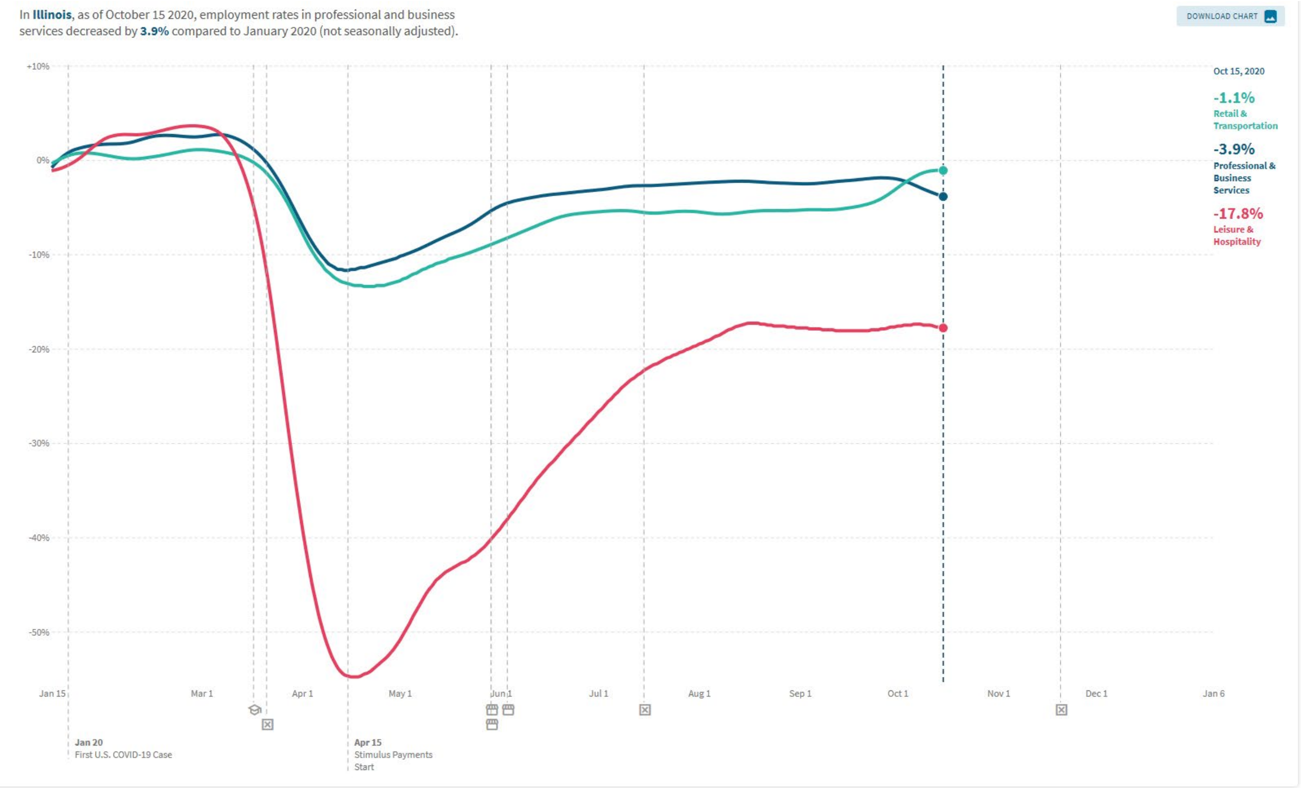
Impact on Consumer Spending in Illinois—strength in some categories



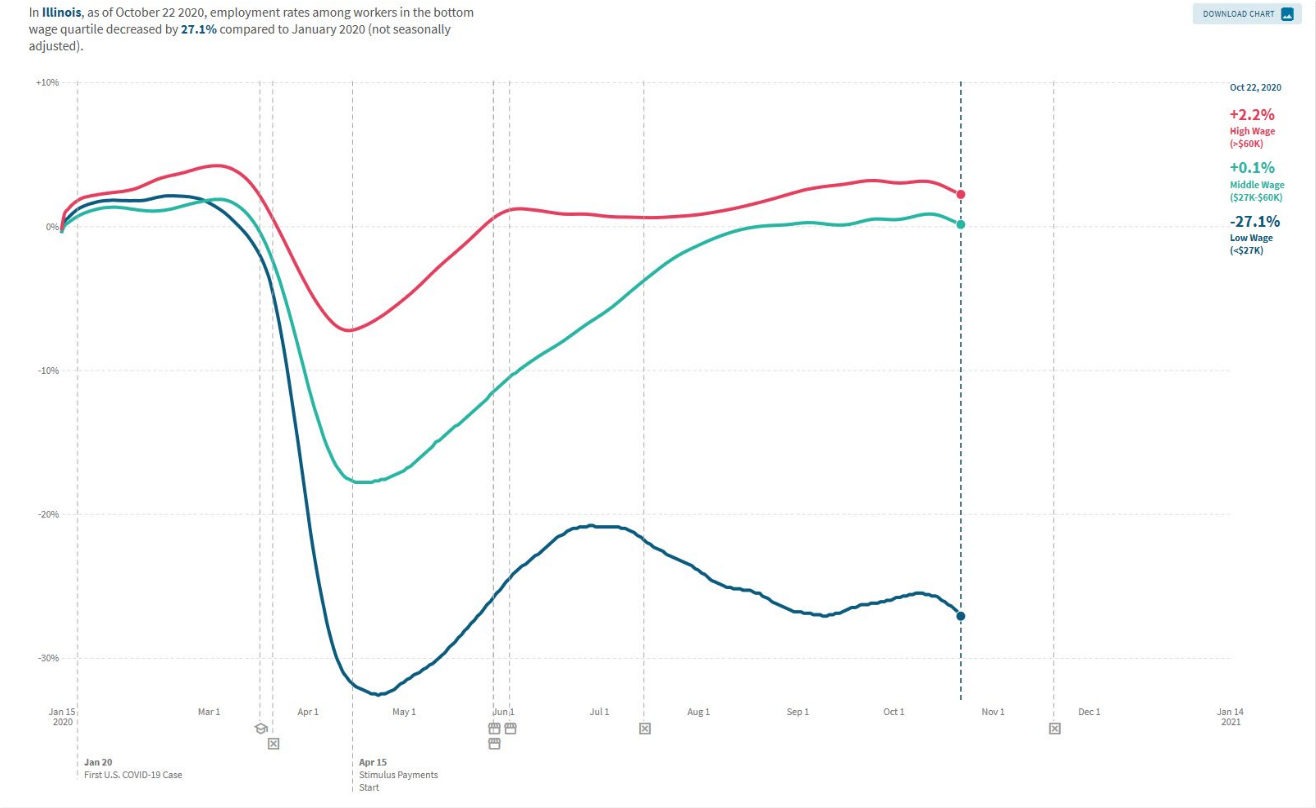
Spending behavior differs based on income group—increase in low wage reflects Federal support, decline in high wage reflects inability to purchase services



What about employment? Again, depends on the industry

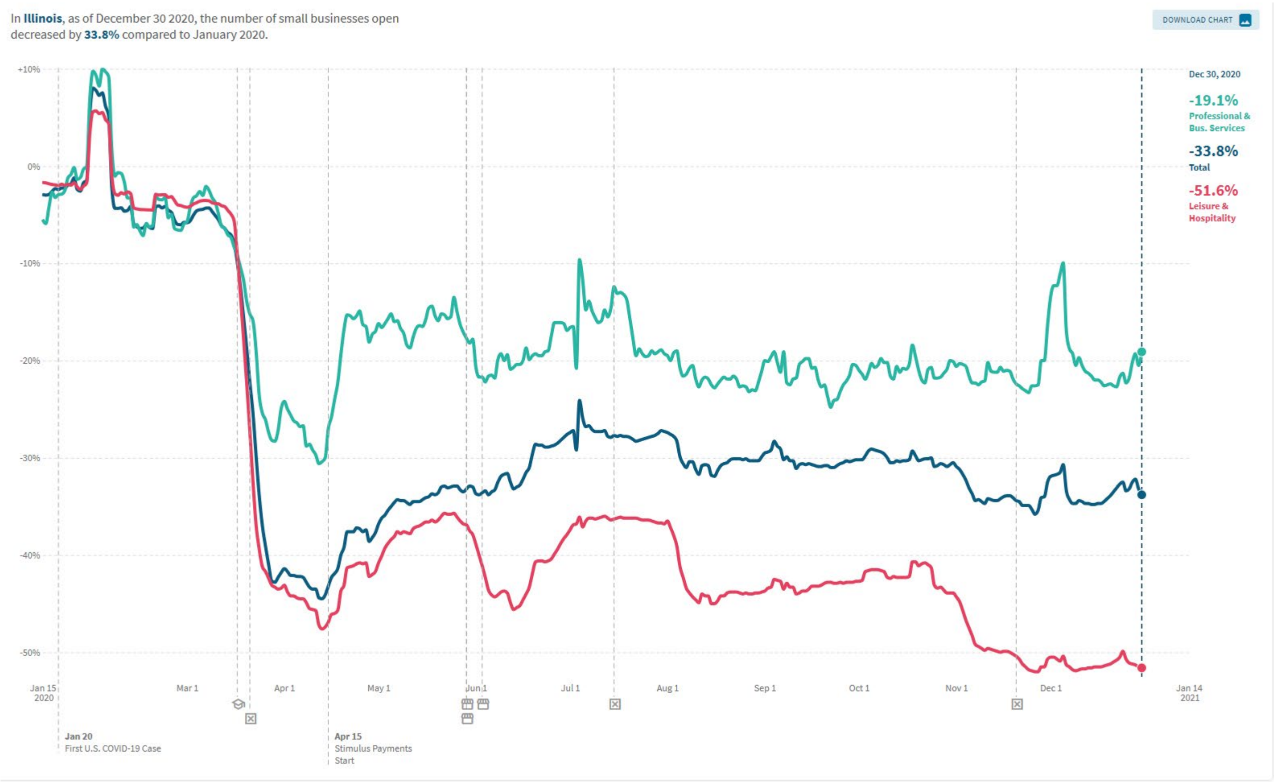


Employment declines have been hardest for low-wage segment

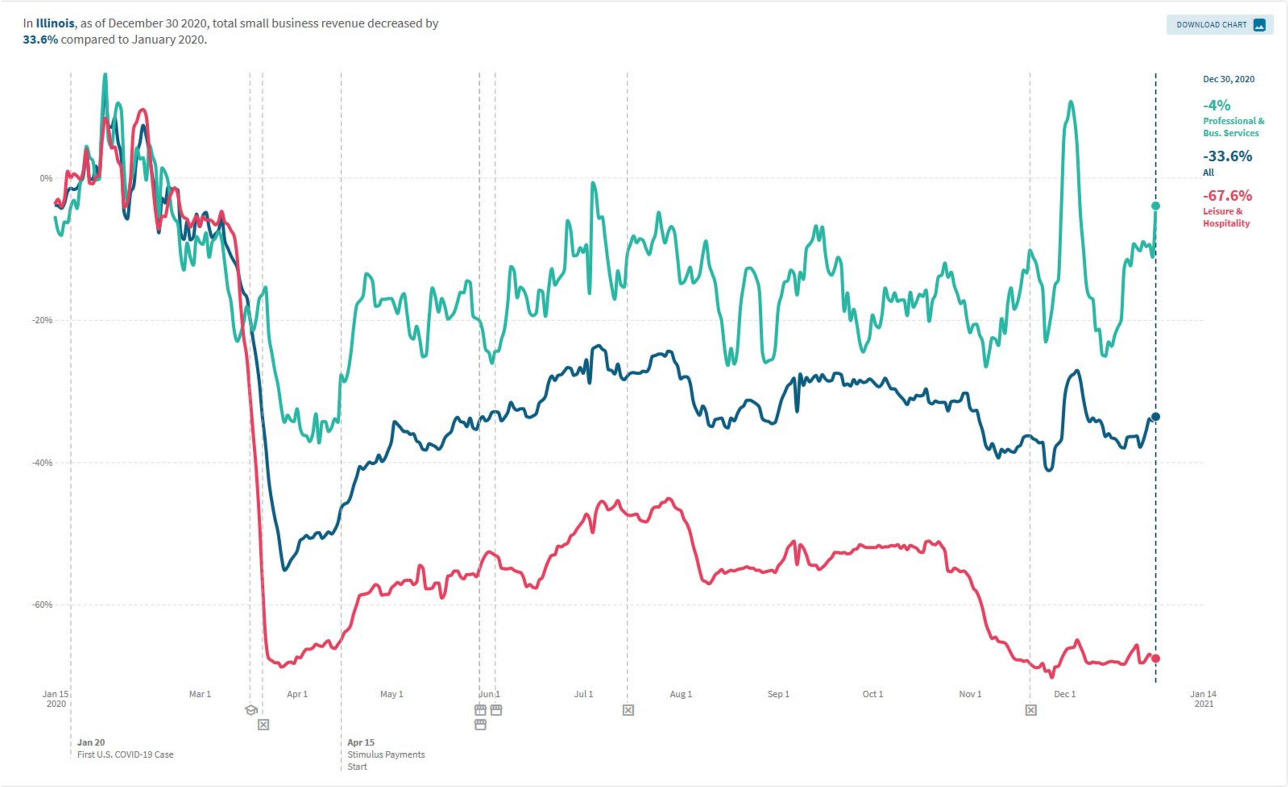


Small business has not fared well

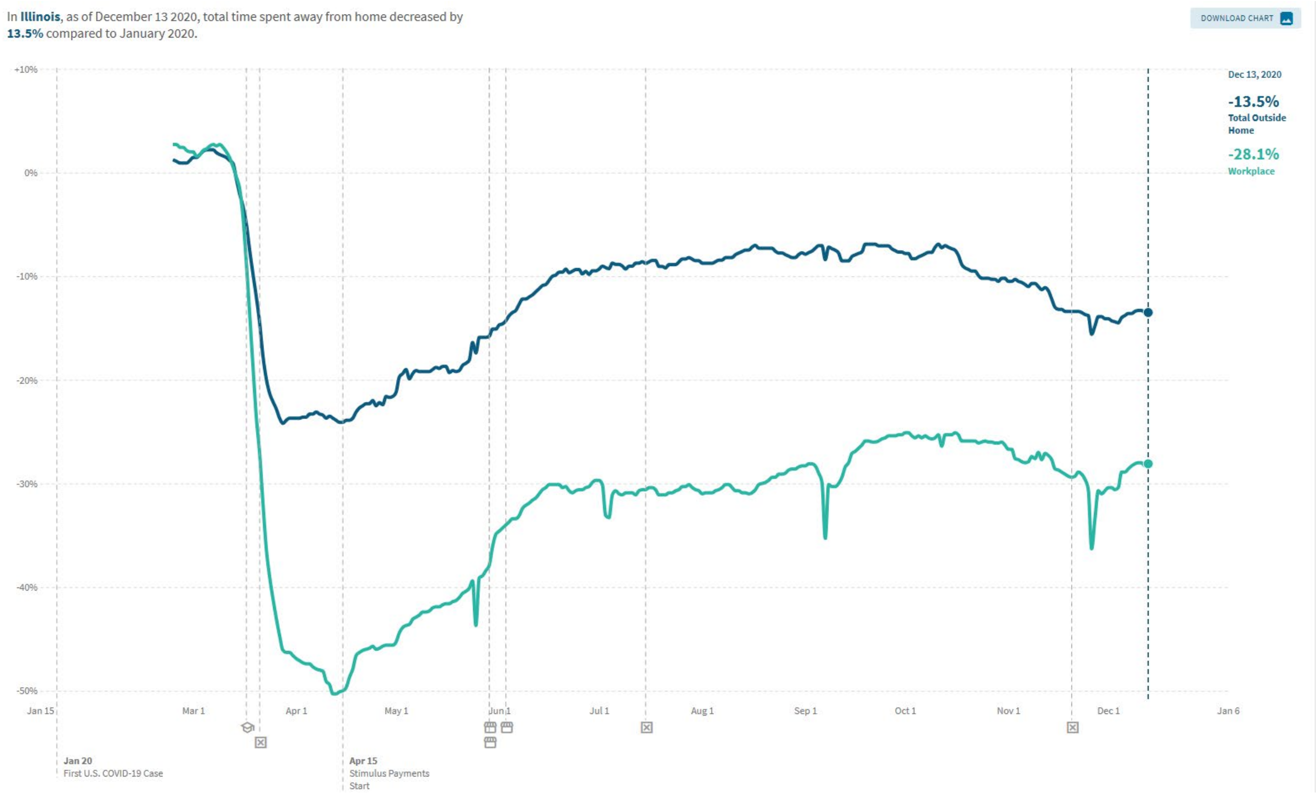
Small leisure and hospitality gets crushed



Small business closings reflect revenue pressures



Clear indicator of the impact of the pandemic—spending less time away from the home, particularly when it comes to work



Two final issues to consider

- Will a lasting impact of the pandemic be a change in the economic geography of where work gets done—urban dedensification
- And of course, Illinois continuing fiscal saga

Will there be a "new" normal? What happens to downtown? (A new Economic geography)

Possible changes:

- Economic activity spreads out. Firms look to develop satellite offices, arbitrage real estate costs, reduce number of employees in the office.
- Smaller, shorter leases. "Real estate" as a consumer product, need for faster adaptation. Example, leasing space for day workers.
- May need to repurpose some office space…usual suspects, healthcare, e-commerce distribution centers, ghost kitchens, event space.
- Redistribute work to cheaper locations. Does the geography of economic activity change? Maybe taxes matter more on the margin.
- Convention/business travel is reduced meaning less hotel and restaurant demand. Some estimates suggest a 30% reduction even post-pandemic.

And finally, what makes Illinois special (but not in a good way) fiscal conditions

Failure of the "Fair" tax was a significant blow to the Governor's strategy to improve fiscal stability.

State still has twin deficits—general fund is still structurally unbalanced (revenues are less than expenditures) and legacy costs such as pension liabilities ($140 billion +) make an increasing claim on state resources.

Both the FY20 ($1.2 billion) and the FY21 ($2.0 billion) budgets relied on borrowing from the Federal Reserve's Municipal Liquidity Fund. Only state to do so (although the New York Metropolitan Transportation Agency also borrowed). Loans must be paid back in 3 years.

Illinois poor condition received a stiff interest rate penalty—3.42% for 3 year $2 billion, a 183 bp spread vs AAA.

Will considering previous revenue options be necessary? Broadened service taxation, taxing certain types of retirement income?

What spending cuts might be considered? Higher education, aid to local governments, pension reform?

Spending on infrastructure—short-term pressure as declines in car and truck travel reduced gas tax revenue but this should come back.

Finally, demographics aren't Illinois friend. Population loss may lead to a loss of 1 or 2 Congressional Districts and less national political influence.

Illinois continues to lose population (7-years straight) but it isn't like the rest of the Midwest is booming

	% Population change 2010-20	number
Illinois	-2.0	-250,000
Michigan	+1.0	+98,884
Ohio	+1.0	+115,365
Wisconsin	-0.9	-54,000
Minnesota	+6.0	+354,000
Indiana	+3.0	+271,000

Are taxes the problem?

Maybe, maybe not.

- In the 2020 Tax Foundation State Tax Rankings, Illinois was 35 (1=best), but the fastest growing state in the Midwest, Minnesota was 45.
- However, the issue may not be current tax level but concern over future taxes needed to repair the state's fiscal condition.
- Why is Illinois losing population? The biggest culprit has probably been reduced immigration. Estimated suggest that immigration was reduced by between 20,000 and 40,000 per year over the decade.
- Finally, population loss is throughout the state. (90% of the state's counties lost population over the last decade. Metro Chicago's population held relatively constant.

Summary

The shape of the pandemic will dictate how (and the pace) of economic recovery

If all goes to plan, there are good reasons to anticipate a strong recovery in the second half of 2021 assuming a vaccine is widely available.

The big unknown is what structural adaptations will occur in the economy post-COVID.