

Economic Outlook for the US and Illinois



Thomas Walstrum

Senior Business Economist

Federal Reserve Bank of Chicago

January 20, 2023

THE VIEWS EXPRESSED IN THIS PRESENTATION ARE MY OWN AND DO NOT NECESSARILY REFLECT THOSE OF THE FEDERAL RESERVE BANK OF CHICAGO OR THE FEDERAL RESERVE SYSTEM.

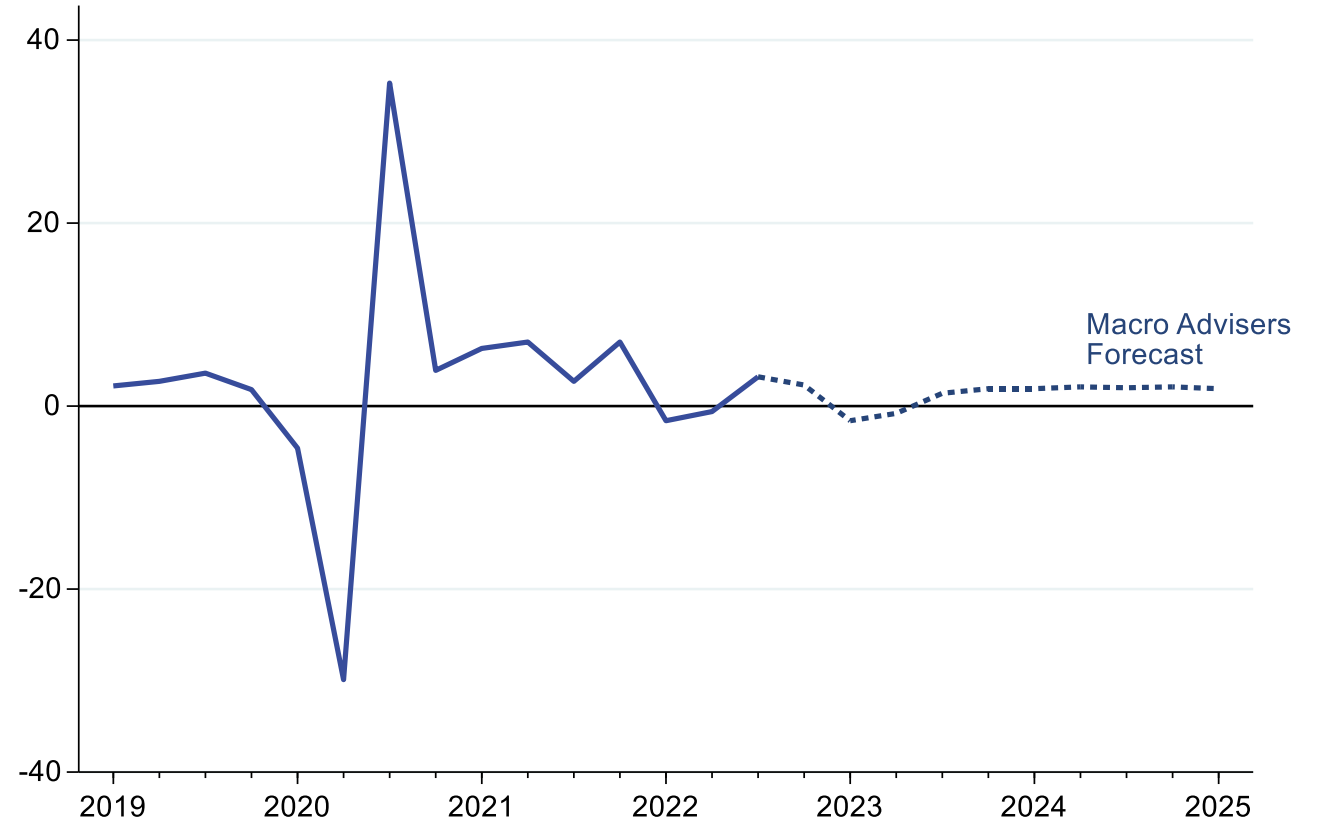
FEDERAL RESERVE BANK *of* CHICAGO

Slow growth ahead

- Forecast
 - Decent chance of a mild recession
 - Fed is more optimistic
 - Q4-2022 to Q4-2023: 0.2%
 - Longer Run: 1.8%
- Risks to the downside
 - Inflation does not ease
 - War in Europe escalates
 - Another large COVID wave

Real GDP growth

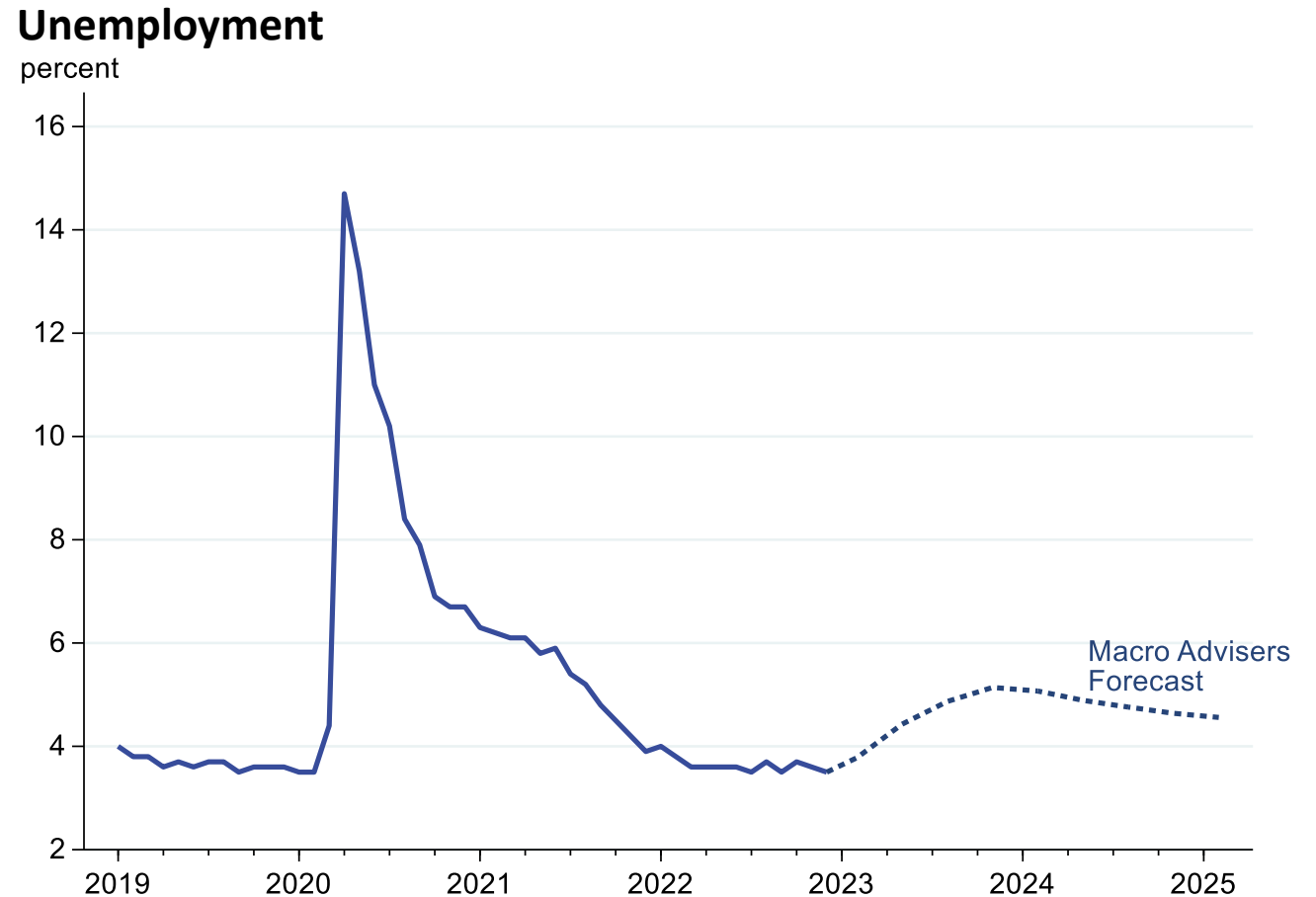
percent, seasonally adjusted annual rate



Source: Bureau of Economic Analysis and Macro Advisers from Haver Analytics

Labor market is still strong

- But that may change in 2023
 - Unemployment rate to top out at 5.1% in Q4-2023
- The Fed is more optimistic
 - As of a month ago, thinks unemployment will be 4.6% in Q4-2023
 - Long run rate: 4.0%

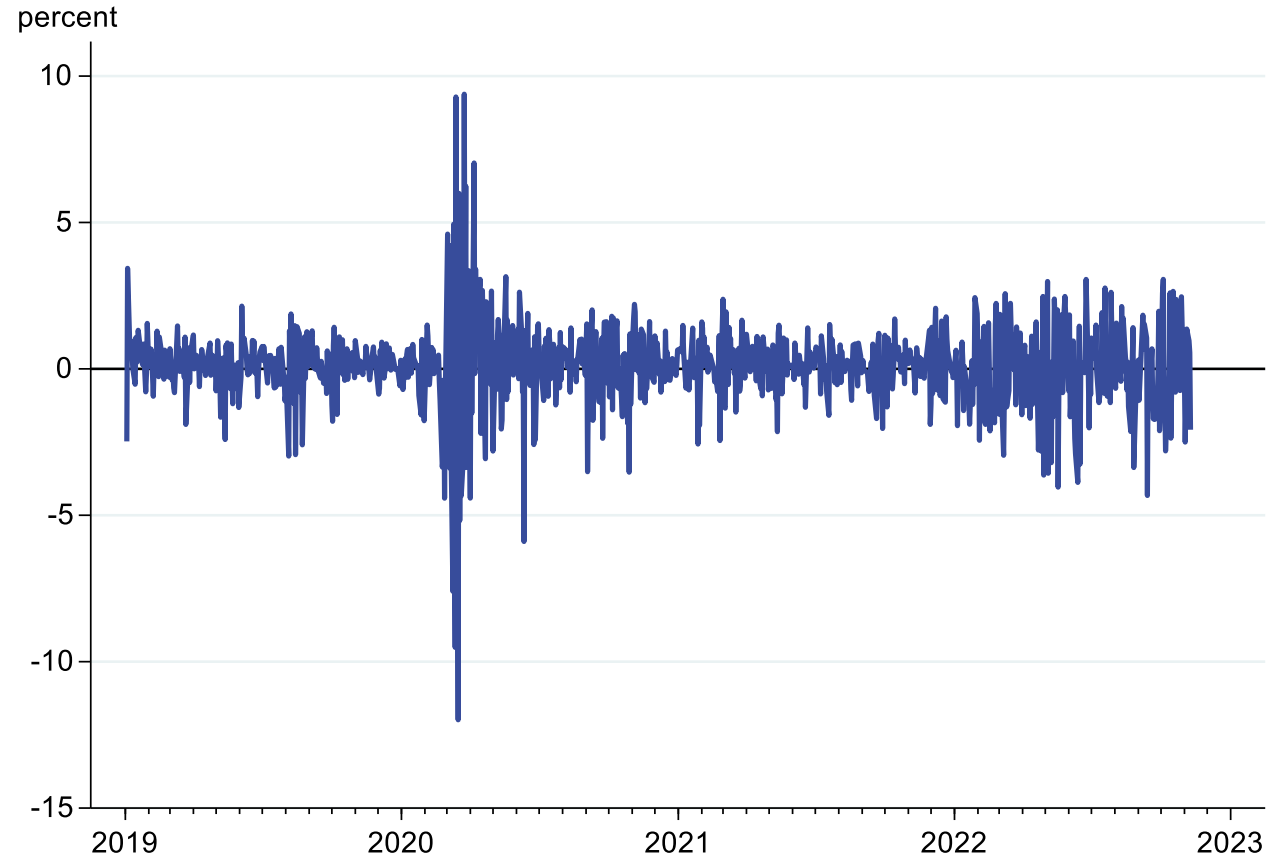


Source: Bureau of Labor Statistics and Macro Advisers from Haver Analytics

There is elevated uncertainty

- Related to the inflation outlook

Daily change in S&P 500 stock price index



Source: Standard & Poor's from Haver Analytics

A Macro 101 model of the US economy

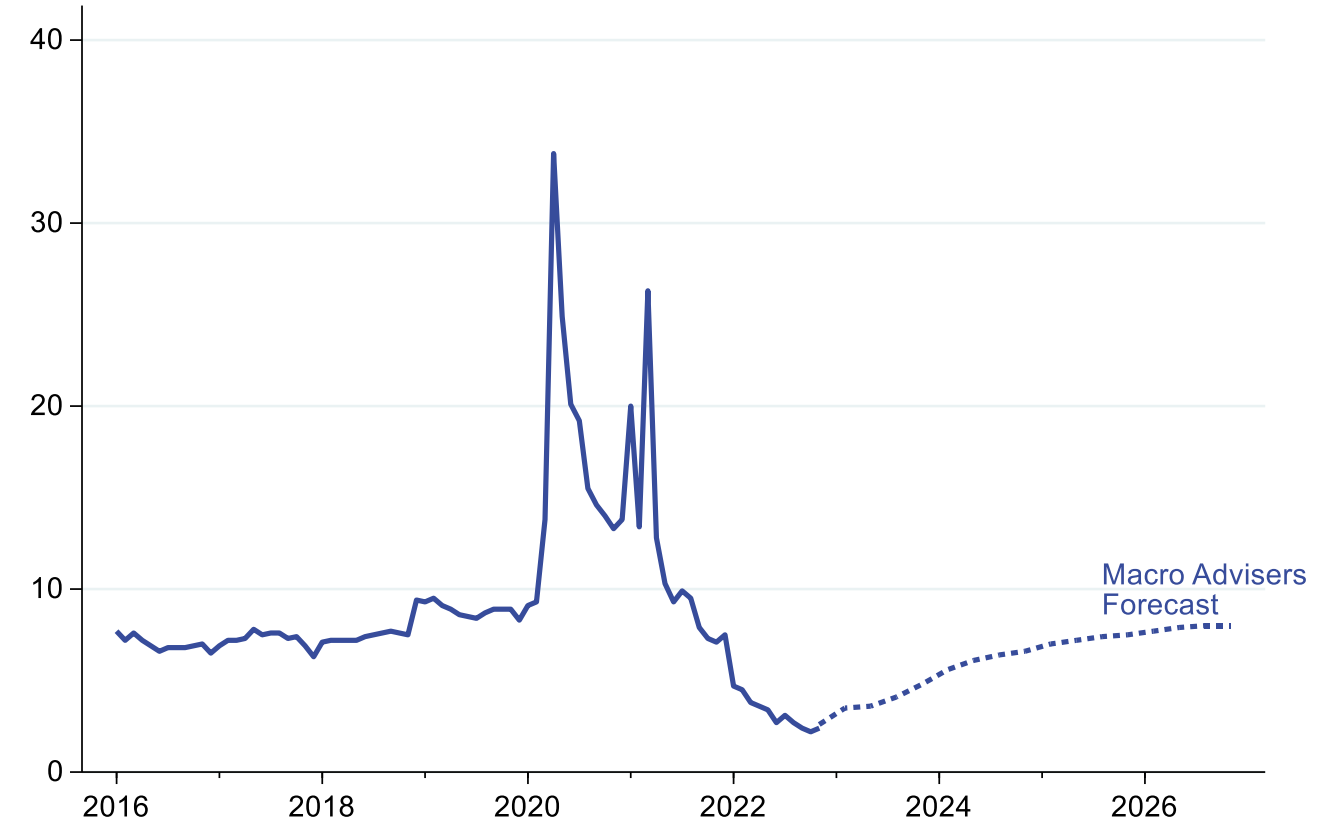
- The economy is a single market
 - One product, one price, one quantity
 - Example: autos
- Supply side
 - All producers added up
 - The capacity of an economy to produce goods and services
- Demand side
 - All consumers added up
 - People's willingness to consume what's being produced
- Measures of aggregate price and quantity
 - Price level and inflation
 - Gross Domestic Product (GDP) and GDP growth

Fiscal stimulus wrapping up

- Savings rate to rise noticeably in 2023, implying built up savings are falling

Personal savings rate

percent

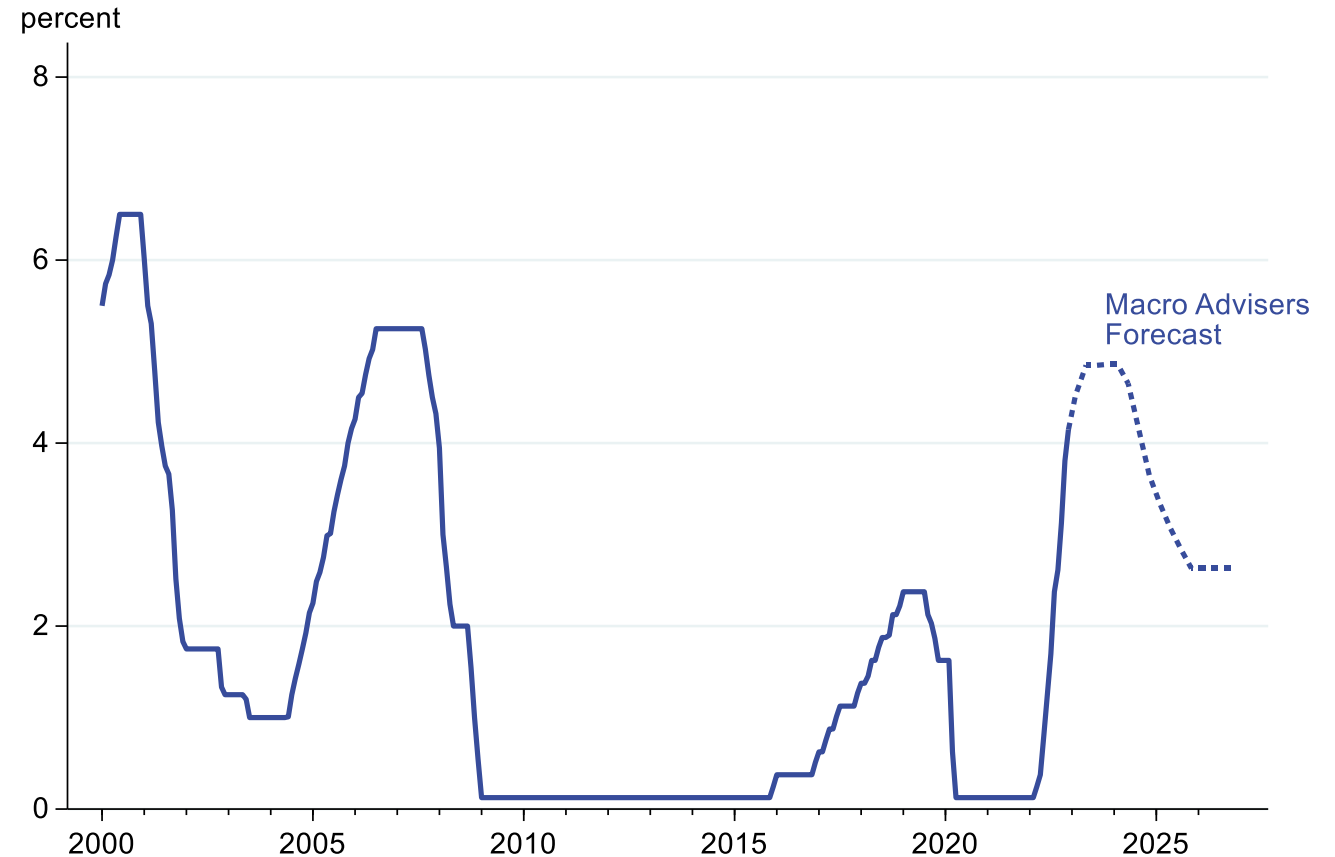


Source: Bureau of Economic Analysis and Macro Advisers from Haver Analytics

Fed in tightening territory

- Fed's policy interest rate recently moved above "neutral", estimated to be 2.5%
- Higher rates clearly slowing down activity in interest rate-sensitive sectors
 - Real estate
 - Finance
 - Manufacturing

Fed Funds Rate



Source: Federal Reserve Board and Macro Advisers from Haver Analytics

Labor supply shock has ended

- But bounceback has been disappointing
- And long run downward trend is expected to continue

Labor force participation rate

percent



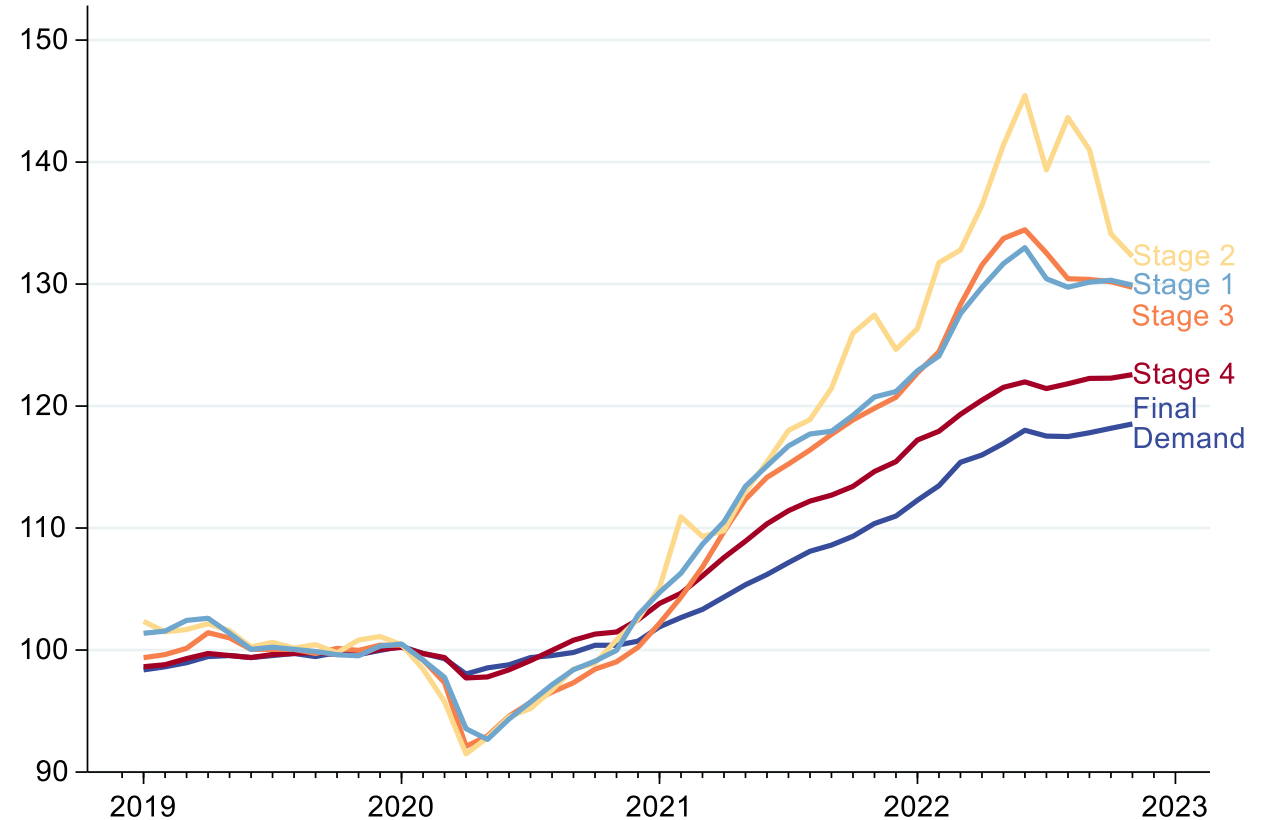
Source: Bureau of Labor Statistics and Macro Advisers from Haver Analytics

Input cost growth has eased

- Labor market a bit looser, supply chain issues noticeably better
- Price relief we're seeing in early production stages will take time to propagate
- Argument to be made that there're more costs to be passed through

Producer price index by production stage

percent, Dec-2019–Feb-2020 = 100



Source: Bureau of Labor Statistics from Haver Analytics

Inflation to slowly fall

- Macro Advisers forecast for Q4-2022 to Q4-2023: 3.1%
- Contingent on slow growth forecast

Core Personal Consumption Expenditures price index
12-month percent change



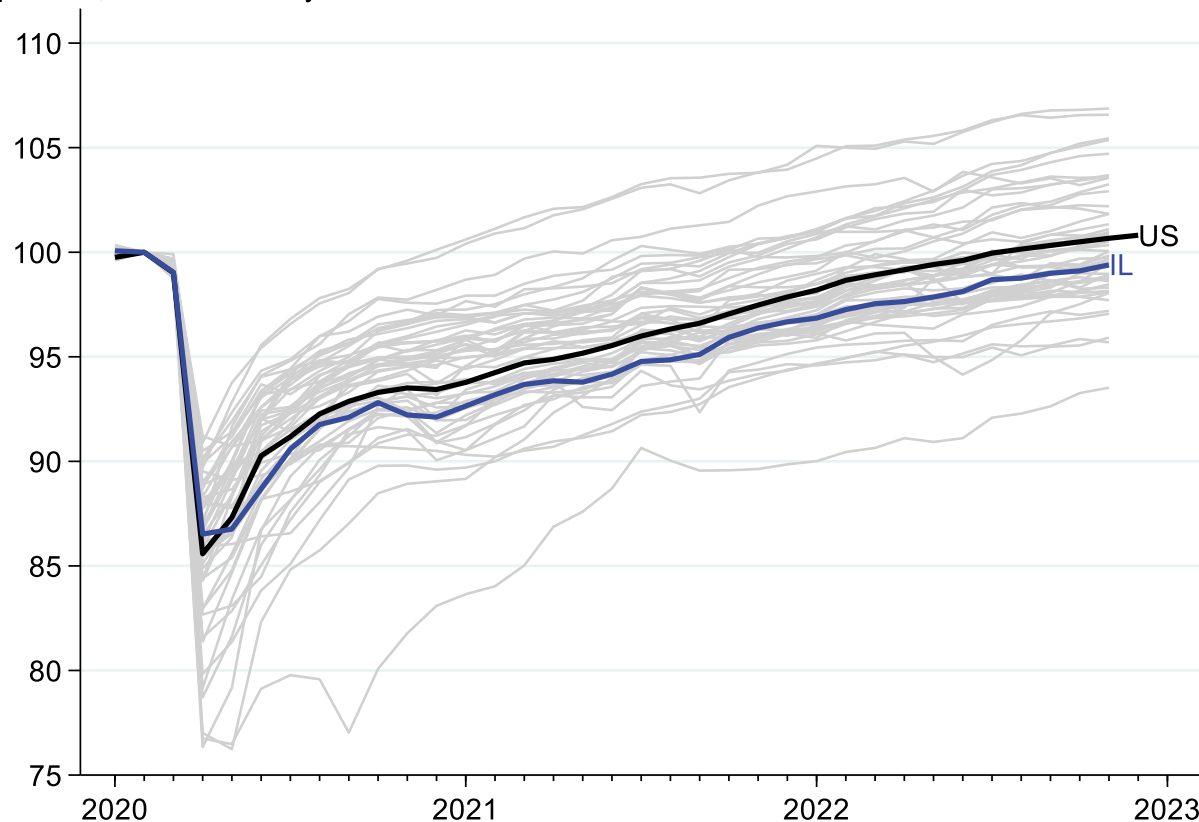
Source: Bureau of Economic Analysis and Macro Advisers from Haver Analytics

Local outlook now largely tied to long run fundamentals

- Effect of initial shock lingering though
- Economic shock worse for:
 - States with large first wave
 - States with large share of leisure and hospitality employment

Payroll employment index for US states

percent, 100 = February 2020

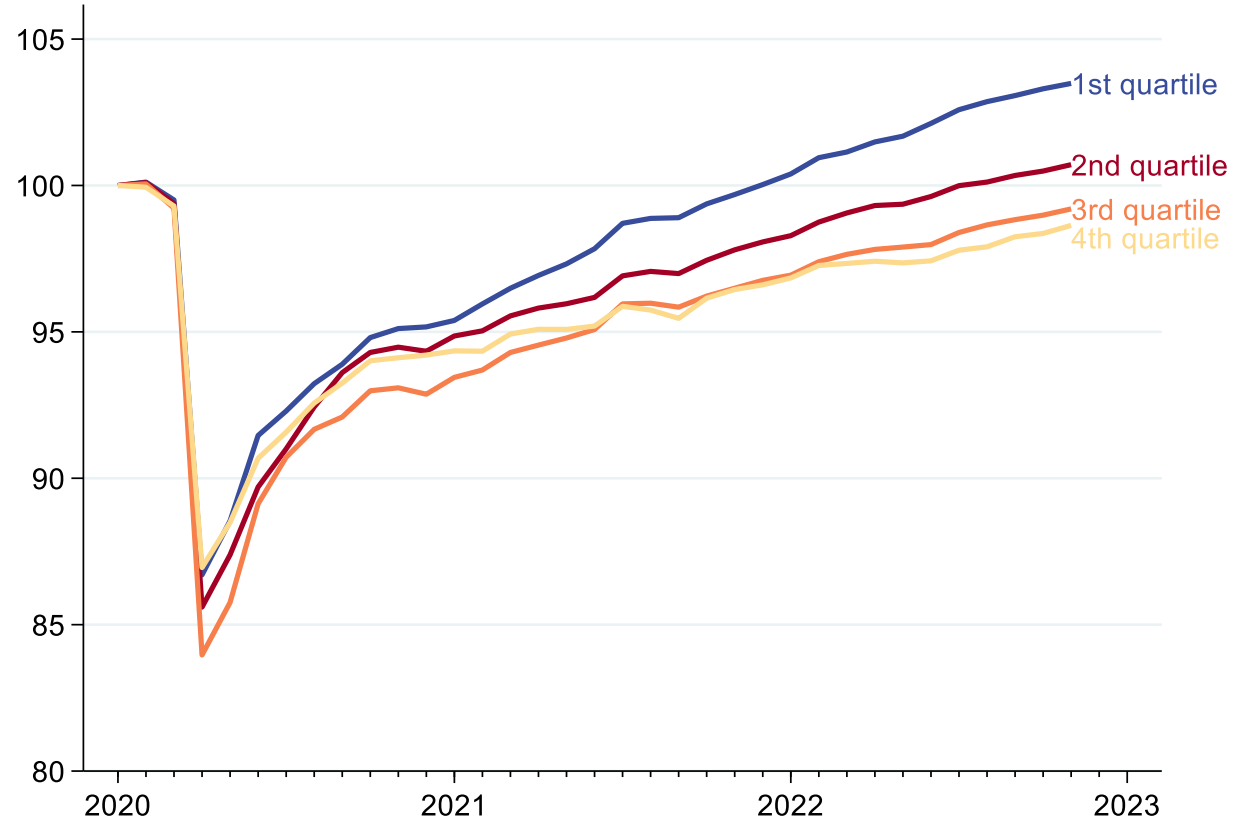


Source: Bureau of Labor Statistics from Haver Analytics

Slow growth places are falling behind again

- Almost all Midwest states are in the third and fourth quartiles of pre-pandemic growth.
 - Exception: Minnesota
 - Illinois is in the 3rd quartile, barely
 - Ranked 37th in employment growth over 5 years before pandemic

Payroll employment index by pre-pandemic growth quartile
percent, 100 = January 2020

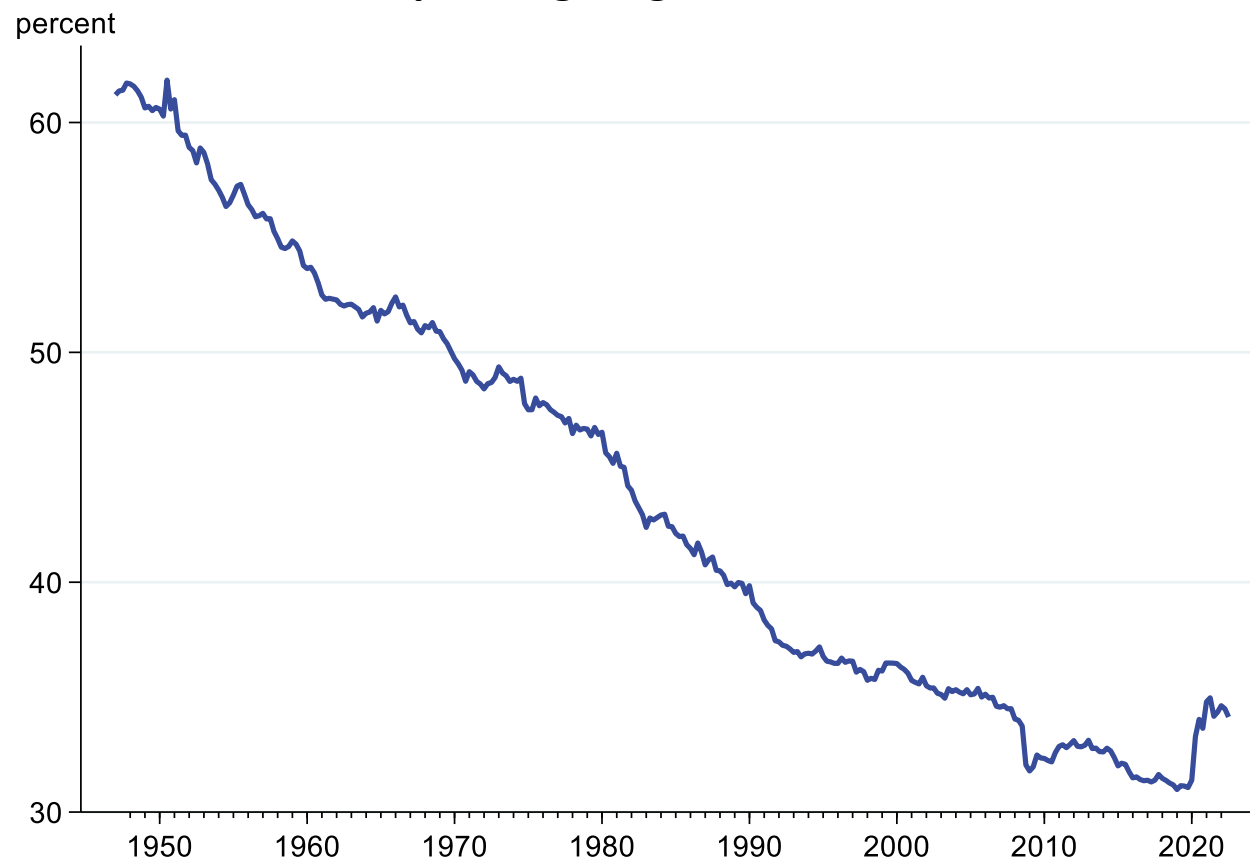


Source: Bureau of Labor Statistics from Haver Analytics

A decades-long decline in relative demand for goods

- Pandemic undid a decade of decline
 - But will it stick?

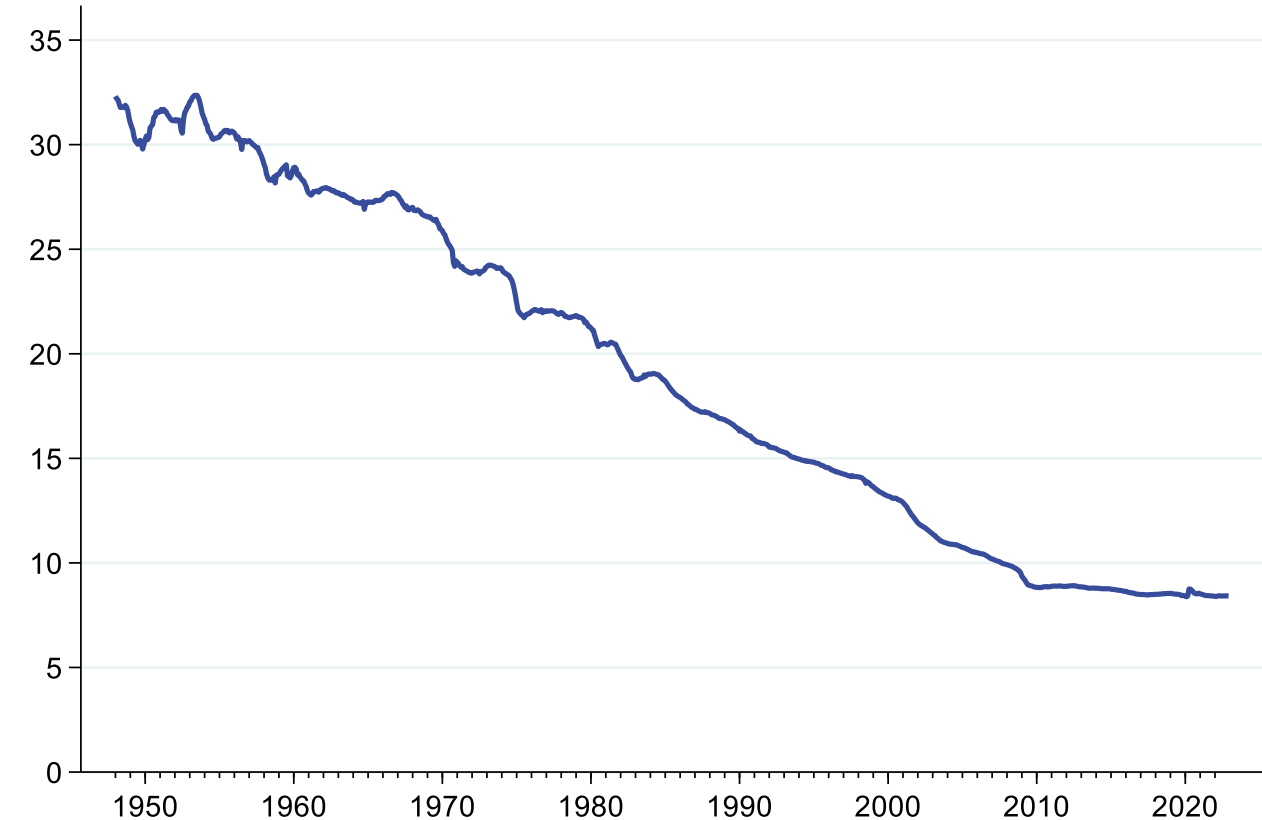
Share of consumer spending on goods



Source: Bureau of Economic Analysis from Haver Analytics

A decades-long decline in manufacturing employment share

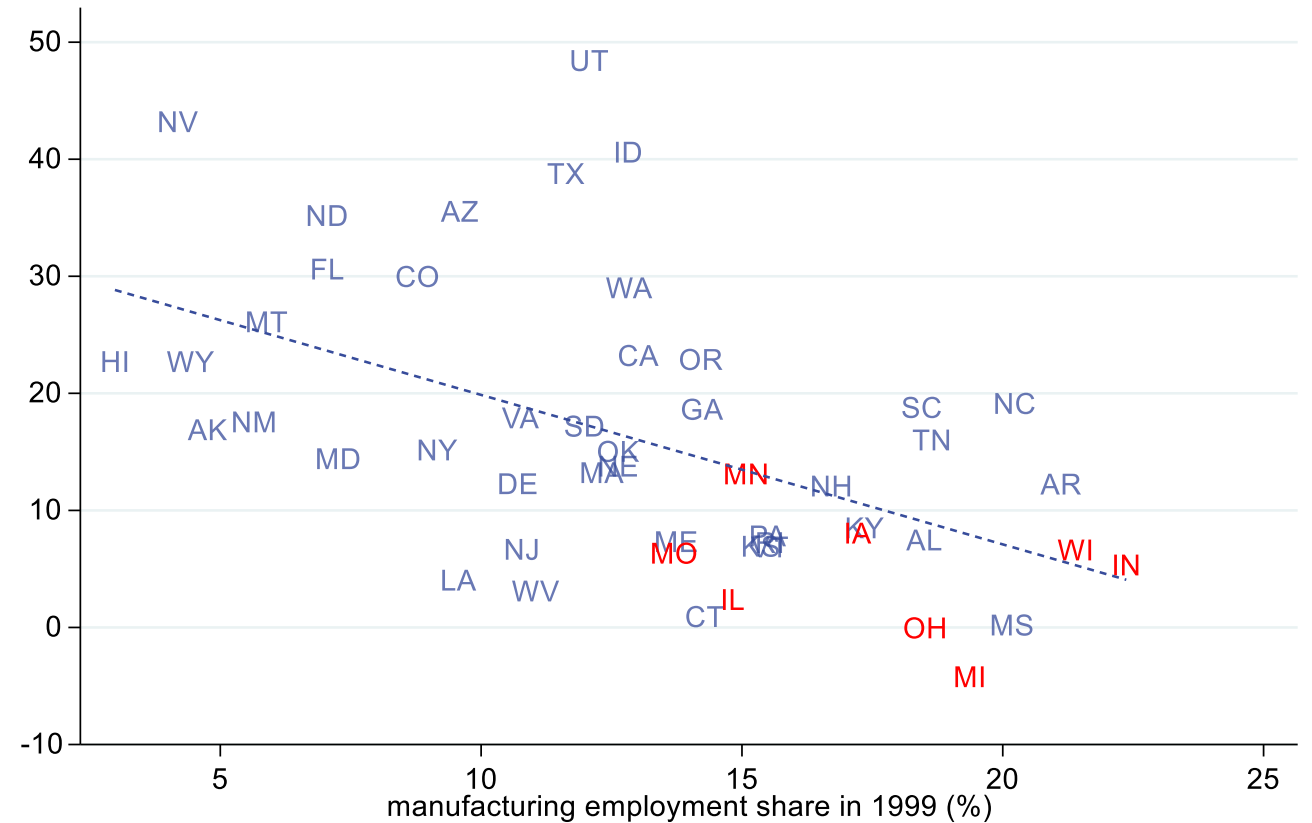
Share of employment in manufacturing
percent



Source: Bureau of Labor Statistics from Haver Analytics

Manufacturing share predicts long run employment growth

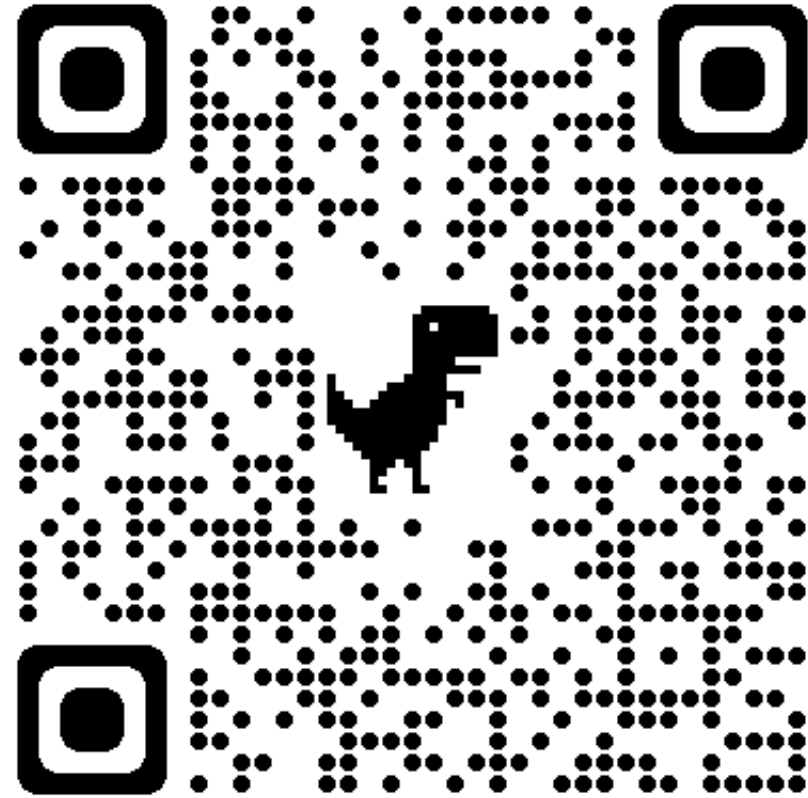
20-year employment growth and manufacturing share
percent change in employment Jan 2000–Jan 2020



Source: Bureau of Labor Statistics from Haver Analytics

Share your knowledge with us.

- Fill out our monthly survey to help keep the Fed up to date on what you're seeing.
- Results are shared with the Chicago Fed's president and help inform monetary policy.
- Responses are kept confidential, but aggregate results are made public.



Q&A
