



The Economy and Monetary Policy: Back to The Future?

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Anna Paulson

Executive Vice President and Research Director

Federal Reserve Bank of Chicago

The views expressed here do not necessarily reflect the views of the Federal Reserve Bank of Chicago or the Federal Reserve System.

As we entered 2023...

Big Banks Predict Recession, Fed Pivot in 2023

Why a global recession is inevitable in 2023

Economists Place 70% Chance for US Recession in 2023

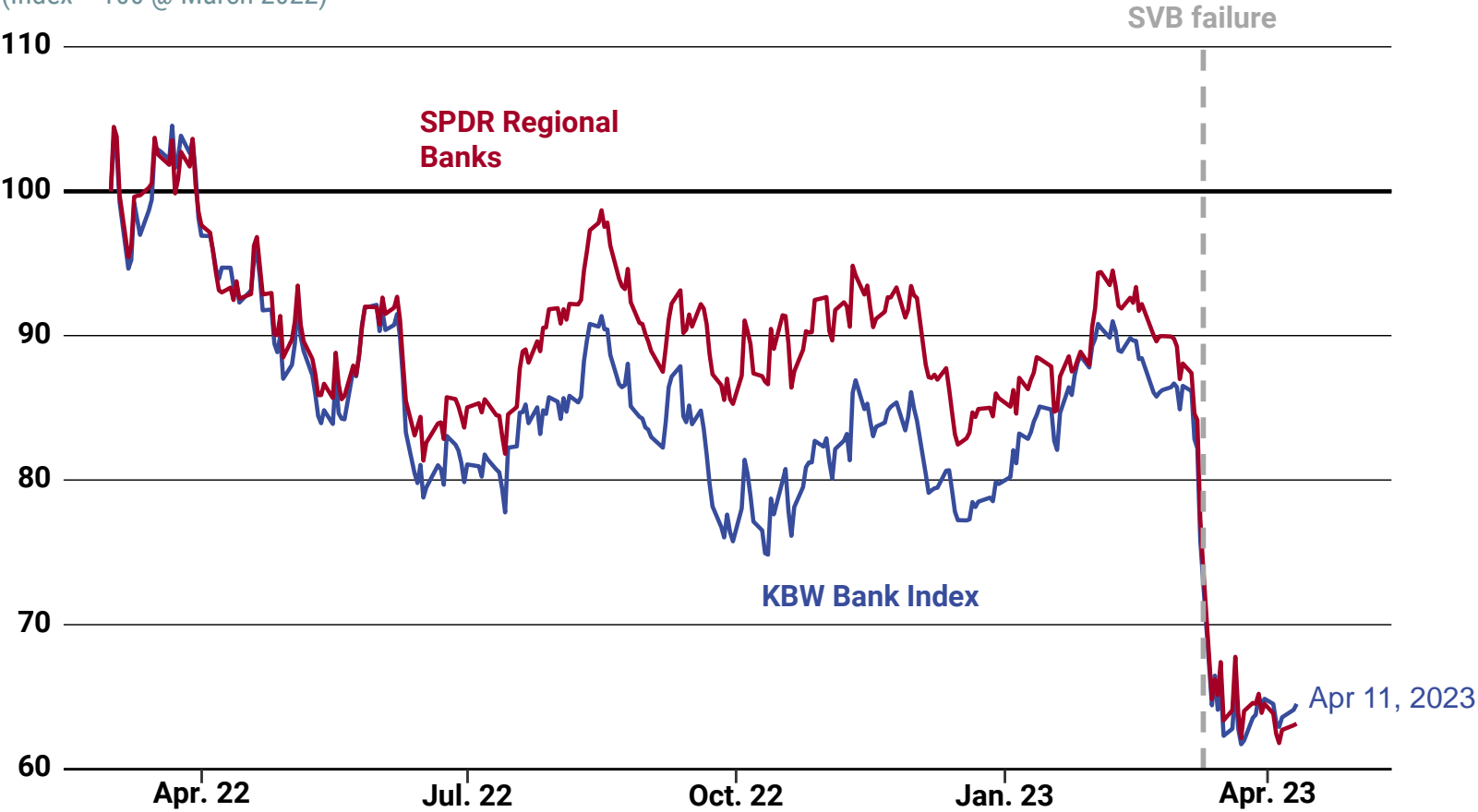
Financial experts say a recession is likely on its way in 2023

Sources: Bloomberg, Economist, Wall Street Journal, WCNC

And that was before the March bank failures

Bank Stock Prices after SVB Failure

(Index = 100 @ March 2022)

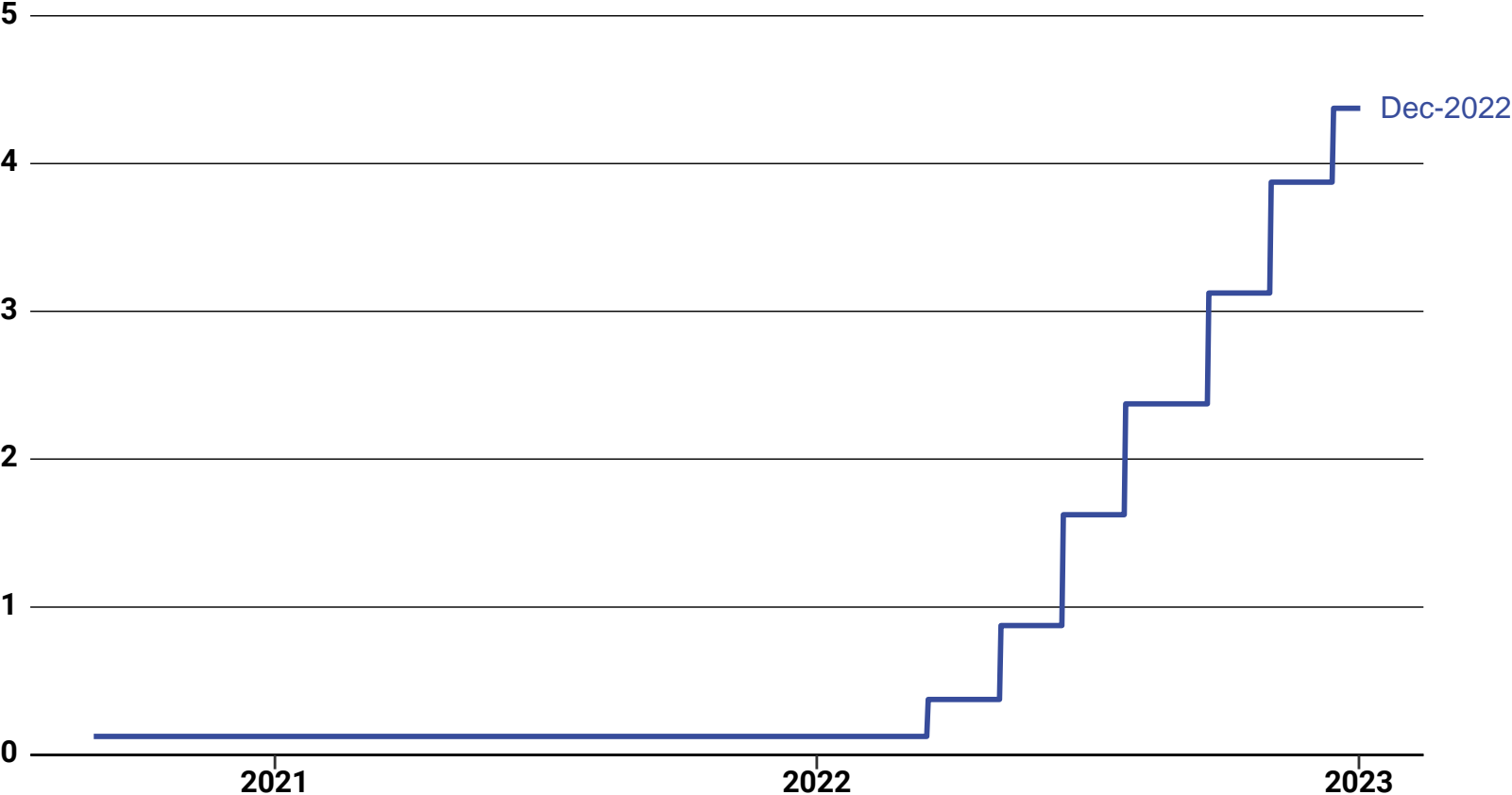


Source: Yahoo! Finance

Why: Monetary policy had tightened a lot, rapidly

Federal Funds Rate Target

(Percent)

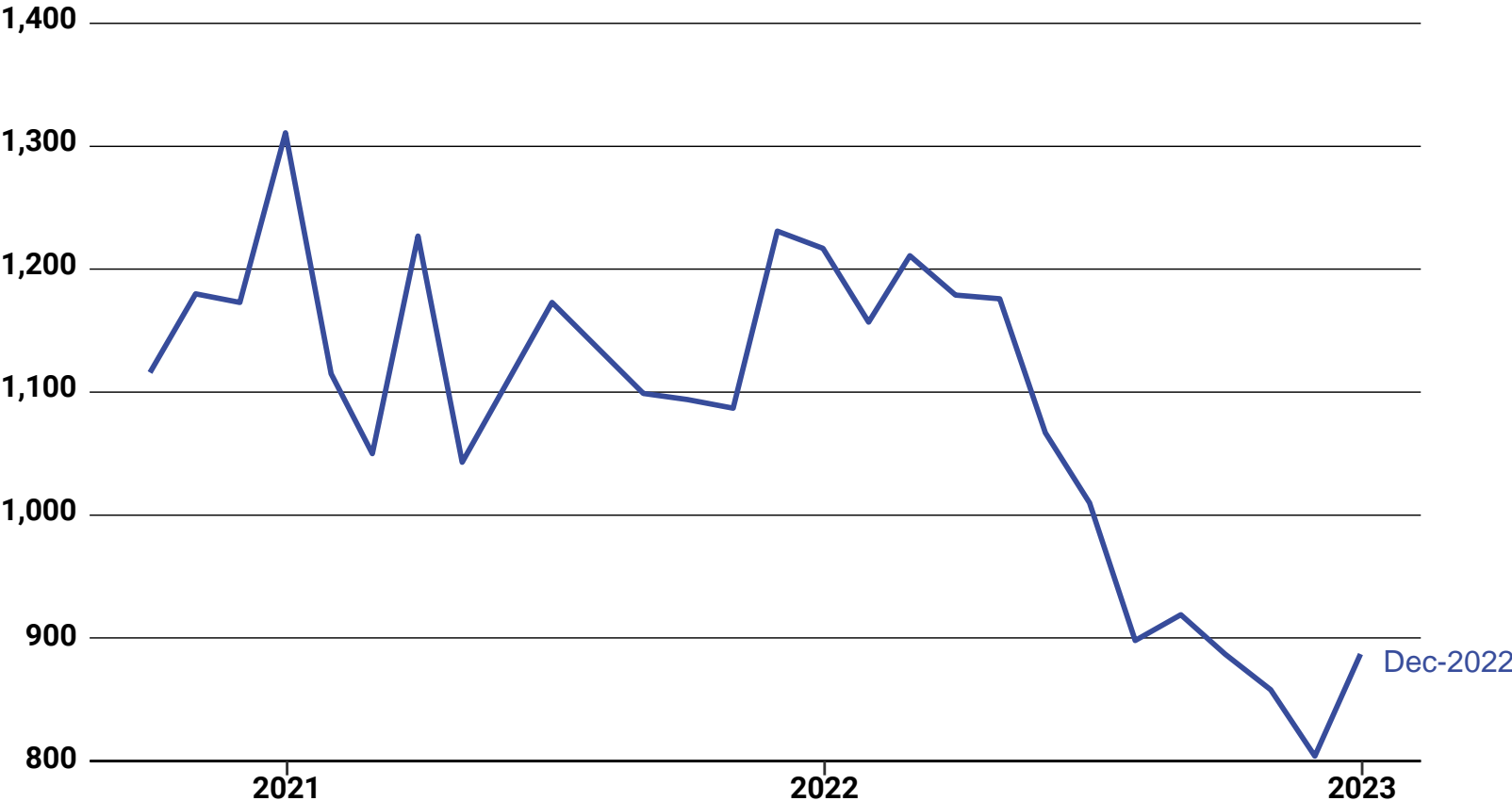


Sources: Federal Reserve Board of Governors

Why: Housing starts were slowing

Single-Family Housing Starts

(Thousands, SAAR)

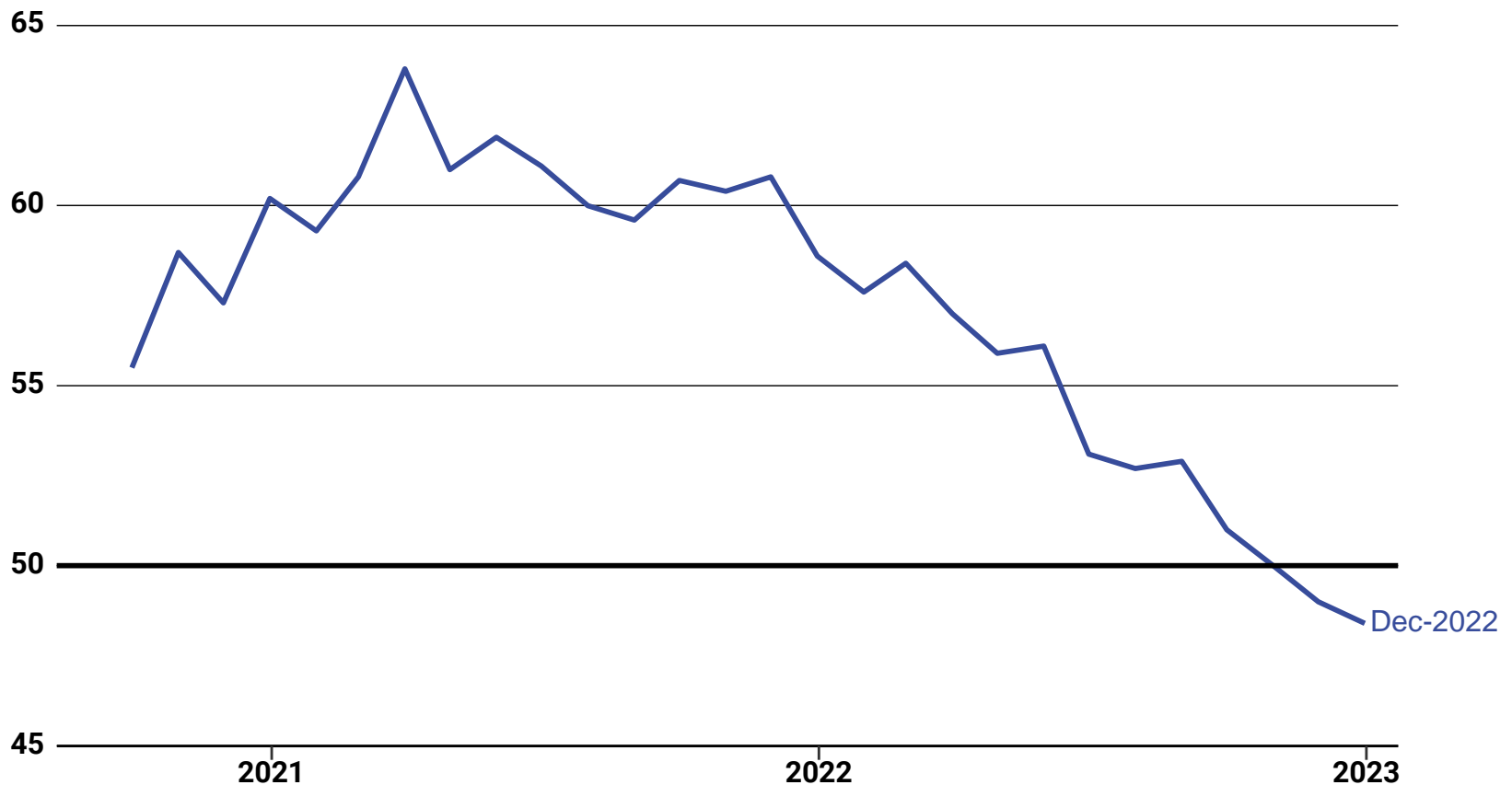


Source: Census Bureau via Haver Analytics

Why: Production indicators signaled a slowdown

ISM Manufacturing: PMI Composite Index

(>50 indicates expansion)

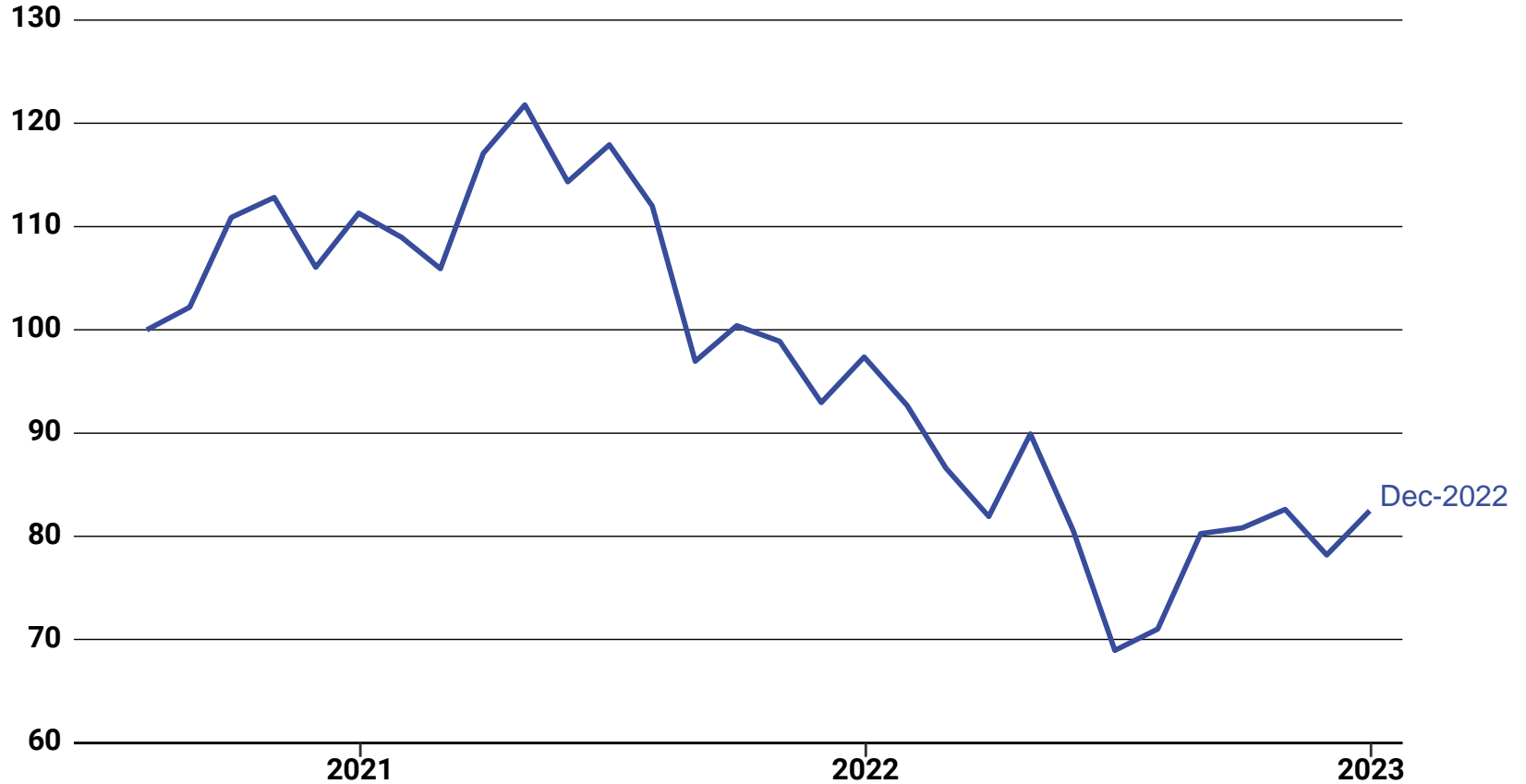


Source: Institute for Supply Management via Haver Analytics

Why: Confidence was low

Consumer Sentiment

(July 2020 = 100)

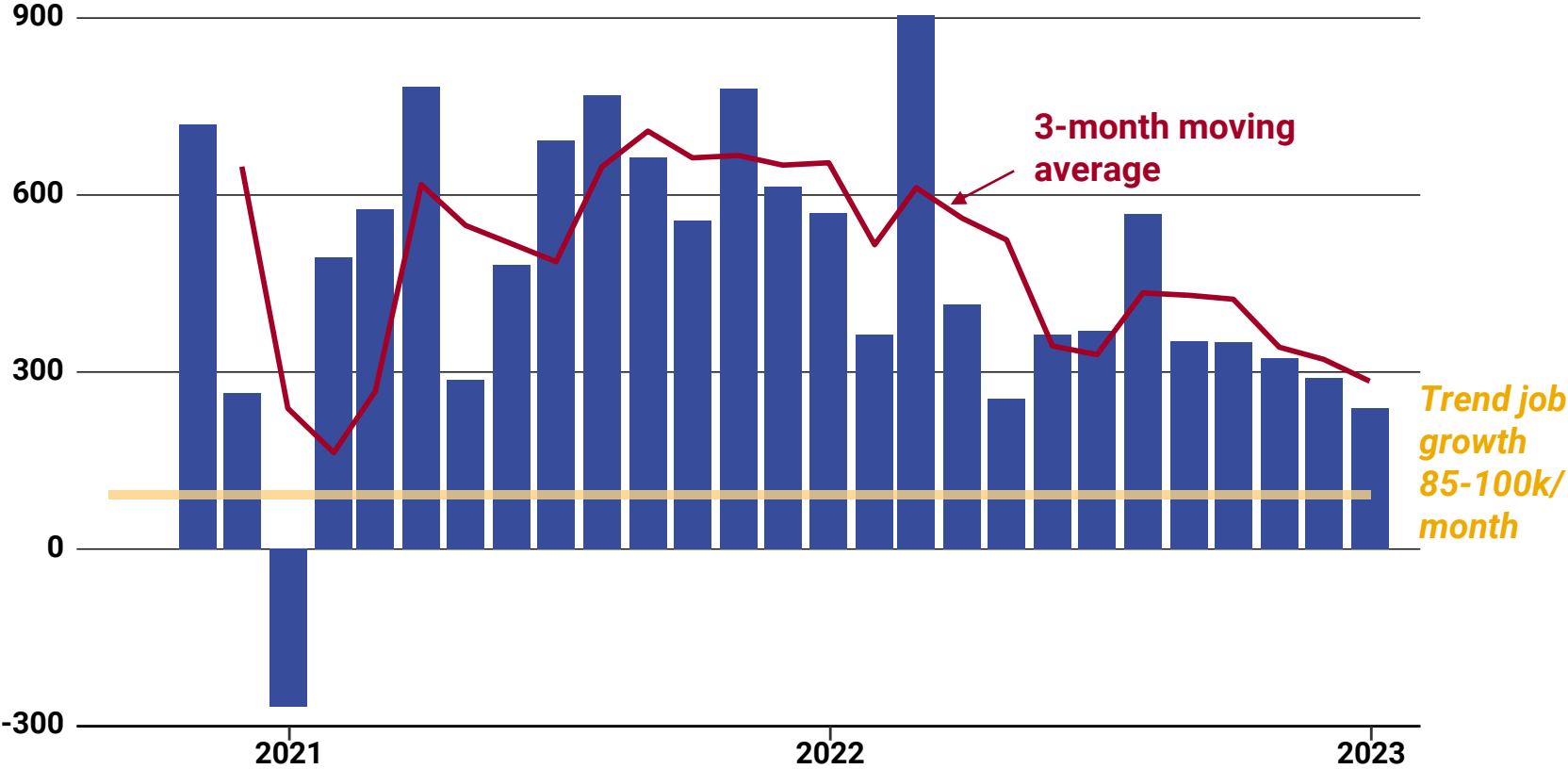


Source: University of Michigan via Haver Analytics

Why: Labor market strong but slowing

Change in Total Nonfarm Payroll Employment

(Thousands, SA)



Source: BLS via Haver Analytics

But 2023 has actually turned out pretty good

	GDP	Unemployment Rate	Total PCE	Core PCE
Dec. 2022 Blue Chip Consensus	0.3	4.4	3.4	3.0
Year-to-Date	3.0	3.9	2.5	3.3

- **Question: How did inflation come down during a year with robust growth and low unemployment?**

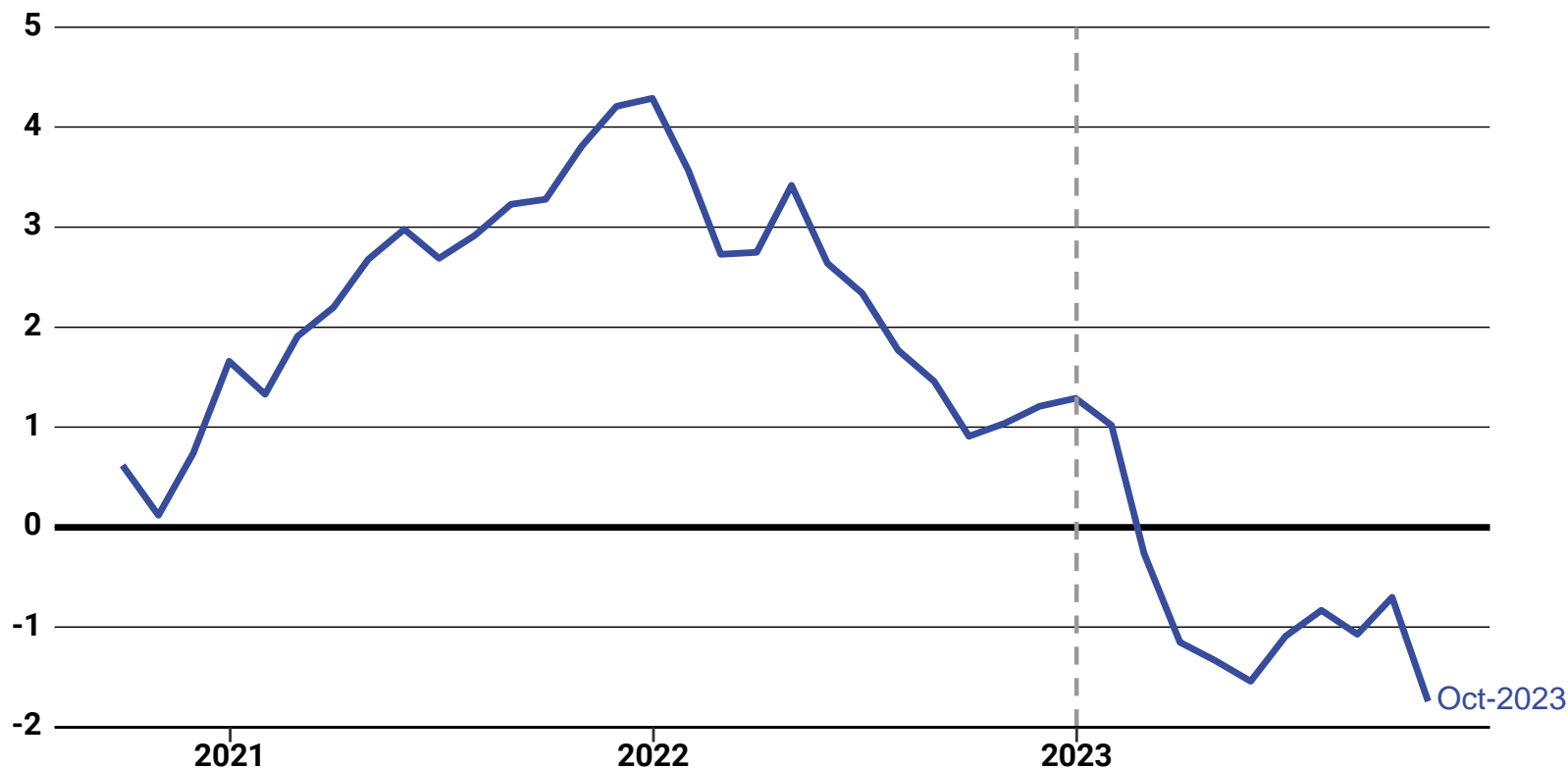
Notes: For Dec. 2022 Blue Chip Consensus forecast, GDP and total and core PCE prices are Q4/Q4 percent changes. Unemployment rate is the Q4 average. For YTD data, GDP is the real GDP growth rate from 2022:Q4 through 2022:Q3; unemployment rate is the rate in Oct. 2023; and total and core PCE inflation are the percent change in the indexes from December 2022 through September 2023.

Sources: Wolters Kluwer, BEA, and BLS via Haver Analytics

Why: Supply pressures eased

Global Supply Chain Pressure Index

(Standard deviations from average)

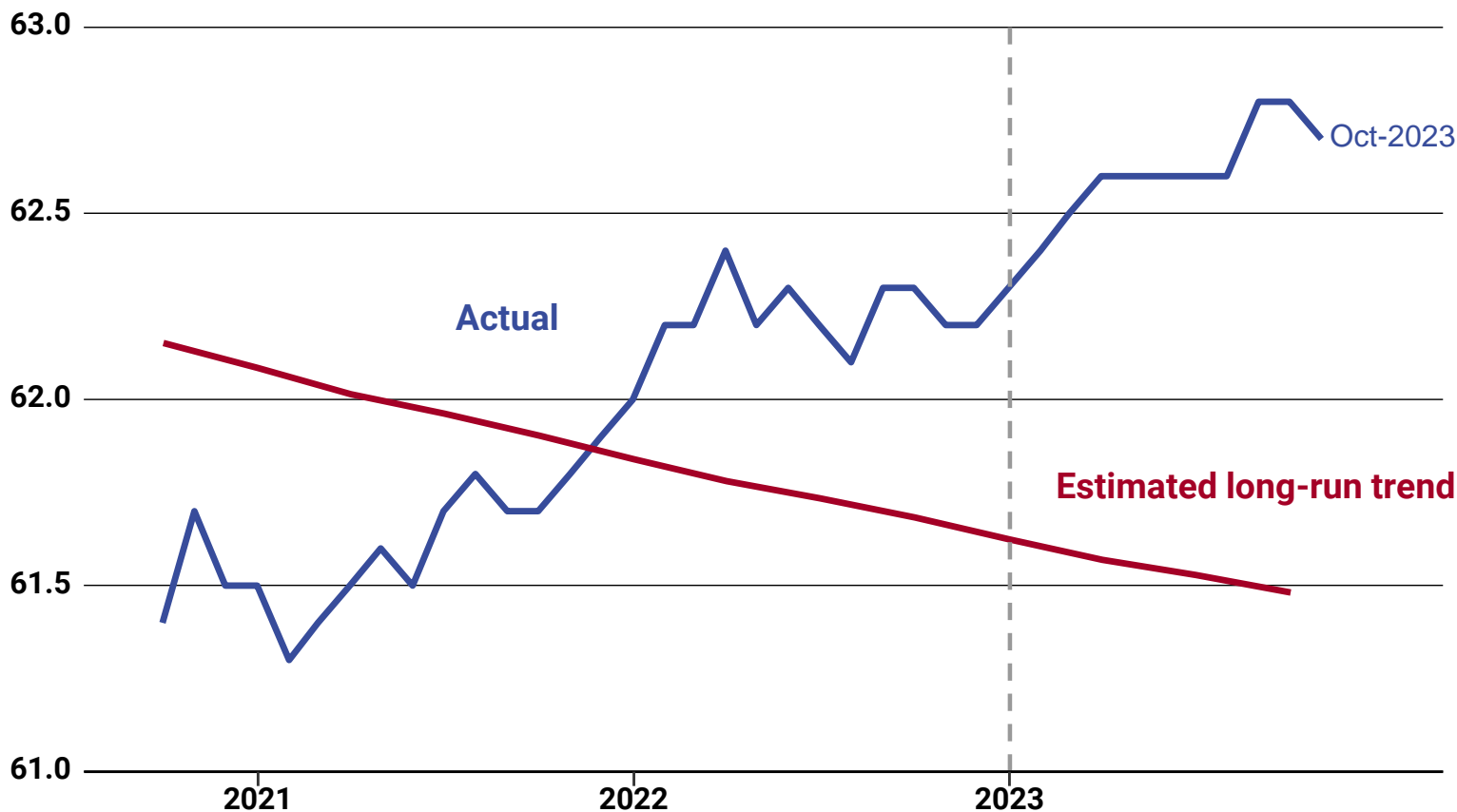


Source: Federal Reserve Bank of New York using data from Bureau of Labor Statistics; Harper Petersen Holding GmbH; Baltic Exchange; IHS Markit; Institute for Supply Management; Haver Analytics; Refinitiv

Why: Labor force participation increased

Labor Force Participation Rate

(Percent, SA)

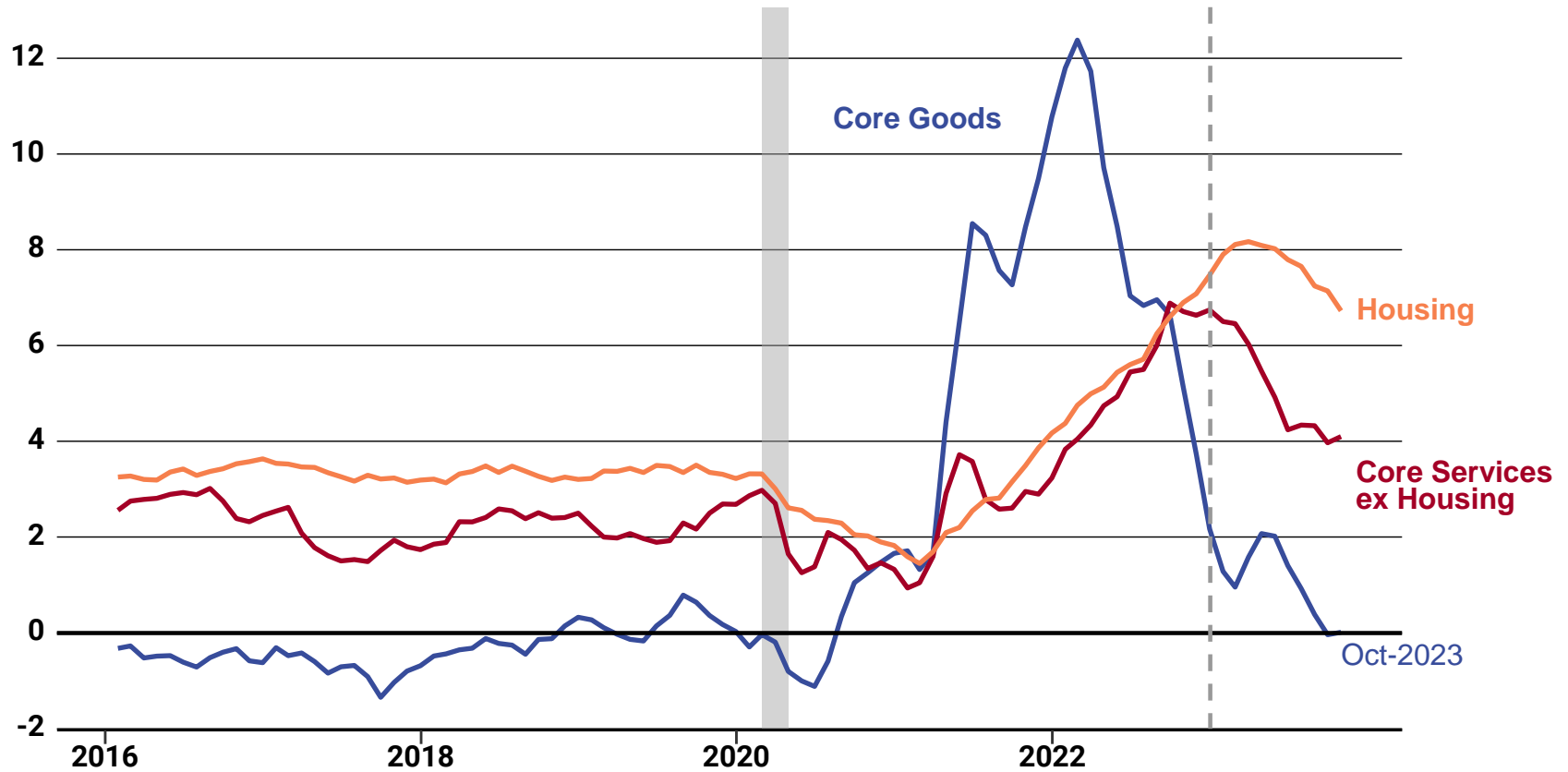


Source: BLS via Haver Analytics; staff calculations using methodology in Aaronson, Hu, Seifoddini, and Sullivan (2014)

Result: Progress on inflation

Core CPI Inflation Components

(12-month percent change)



Source: BLS via Haver Analytics; staff calculations

2024: Back to the future?

Recession will hit the US in 2024 – so get ready for massive interest-rate cuts

UCLA economists foresee weak U.S. economy in 2024, but no recession

Global economic growth to slow in 2024

Recession Forecast Still Right For Late 2023 Or Early 2024

Sources: Forbes, UCLA, World Economic Forum, Yahoo! Finance

Back to the future, but with lower inflation

	GDP	Unemployment Rate	Total PCE	Core PCE
2023 Blue Chip Median Forecast (Dec. 2022)	0.3	4.4	3.4	3.0
Year-to-Date	3.0	3.9	2.5	3.3
2024 Blue Chip Median Forecast (Nov. 2023)	0.8	4.3	2.3	2.4

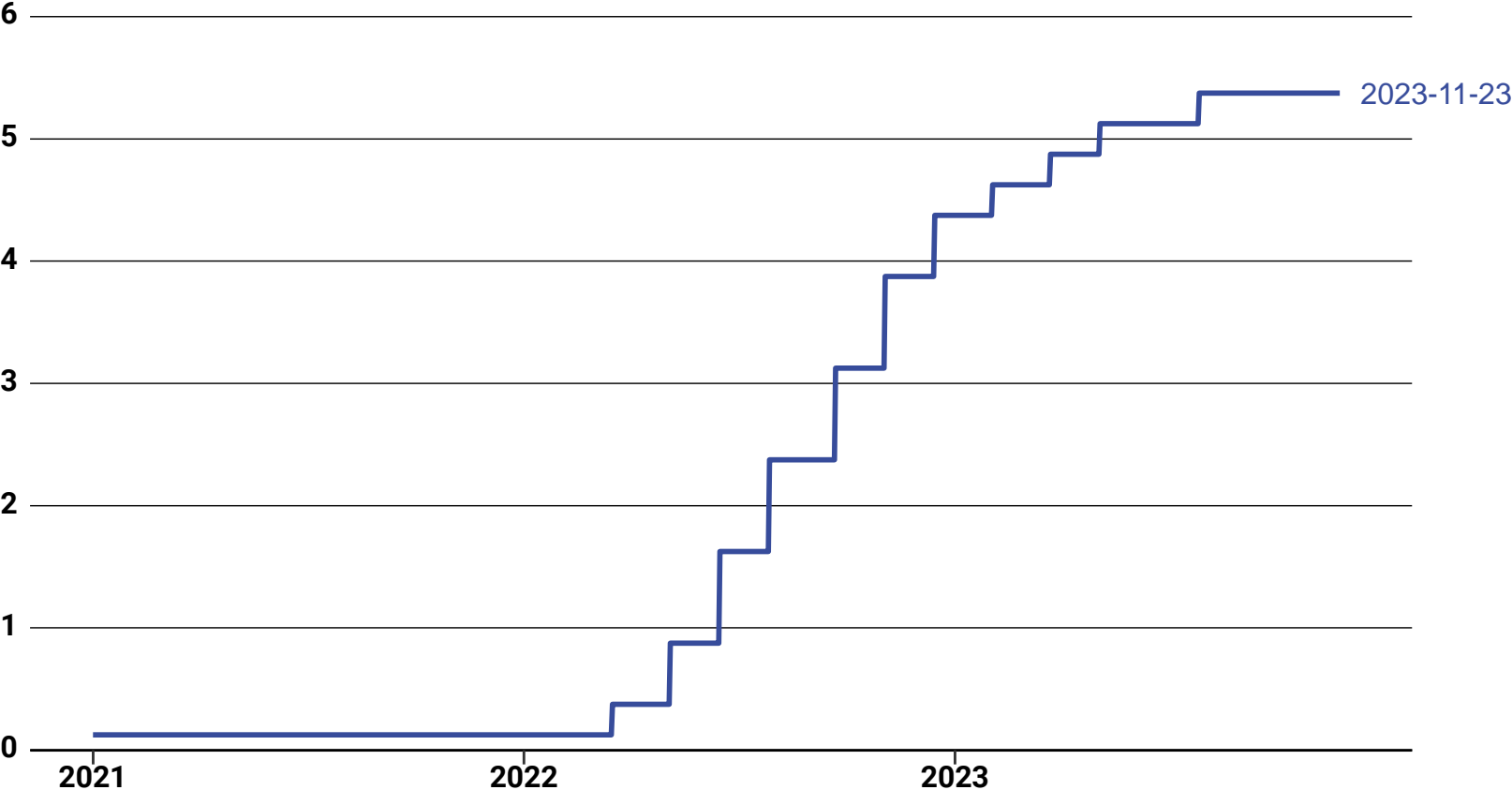
Notes: 2023 Blue Chip Forecast as of December 2022; 2024 Blue Chip Forecast as of November 2023. For Blue Chip forecasts, GDP and total and core PCE prices are Q4/Q4 percent changes. Unemployment rate is the Q4 average. For YTD data, GDP is the real GDP growth rate from 2022:Q4 through 2022:Q3; unemployment rate is the rate in Oct. 2023; and total and core PCE inflation are the percent change in the indexes from December 2022 through September 2023.

Sources: Wolters Kluwer, BEA, and BLS via Haver Analytics

Monetary policy remains restrictive

Federal Funds Rate

(Percent)

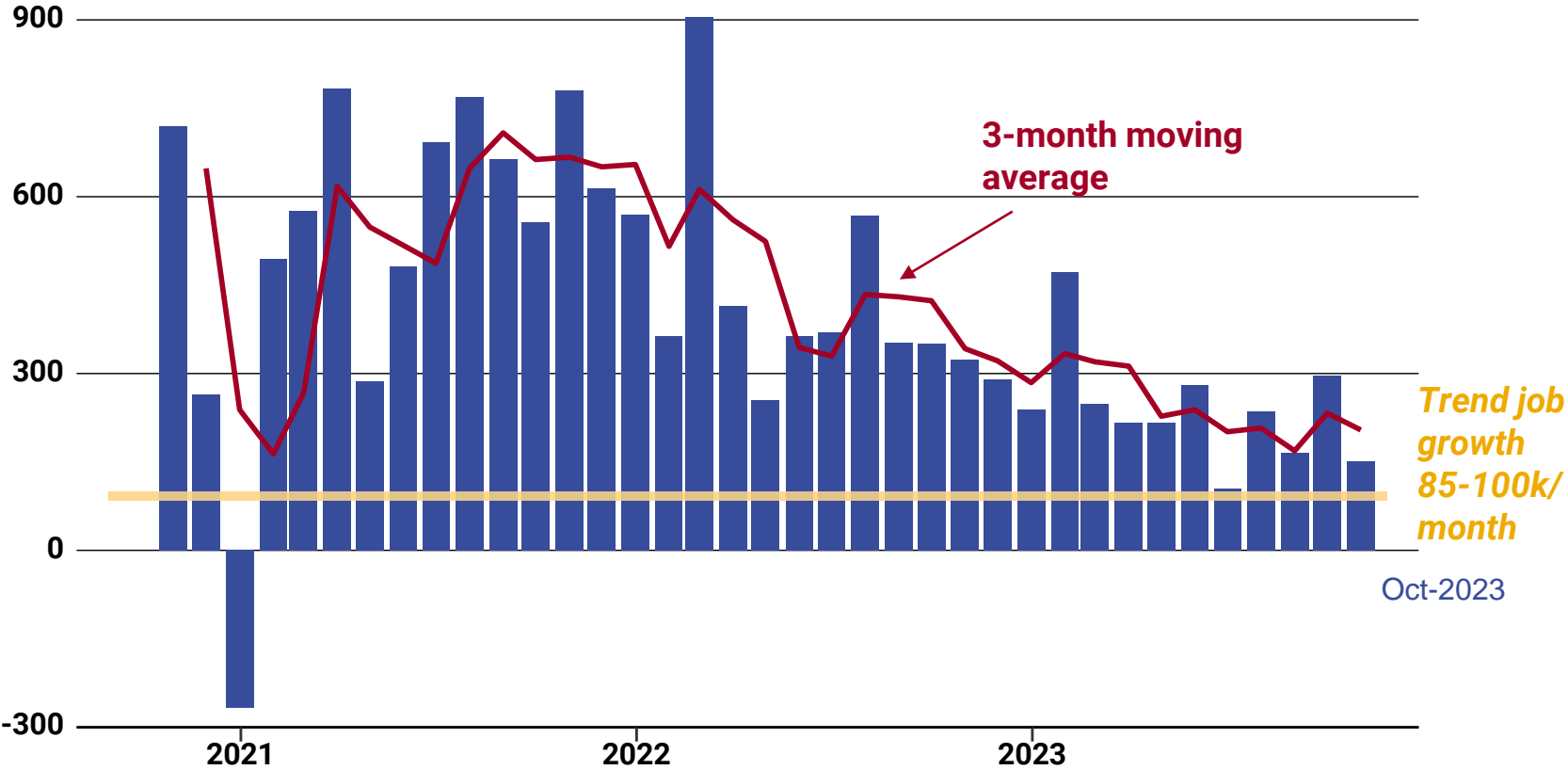


Source: Federal Reserve Board of Governors

Labor market still strong

Change in Total Nonfarm Payroll Employment

(Thousands, SA)

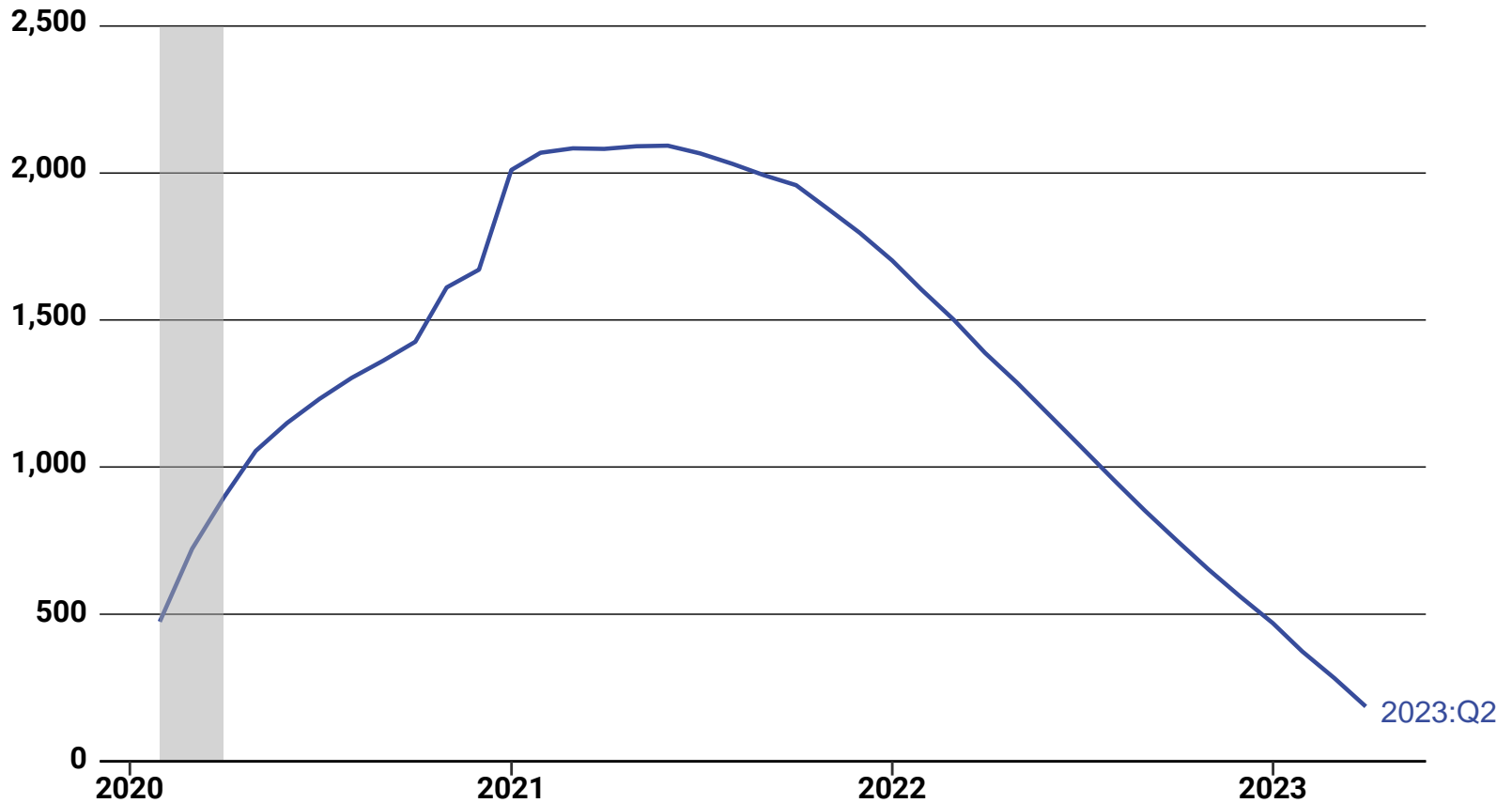


Source: BLS via Haver Analytics

Households have less “extra” savings

Stock of Excess Savings

(\$ billions)

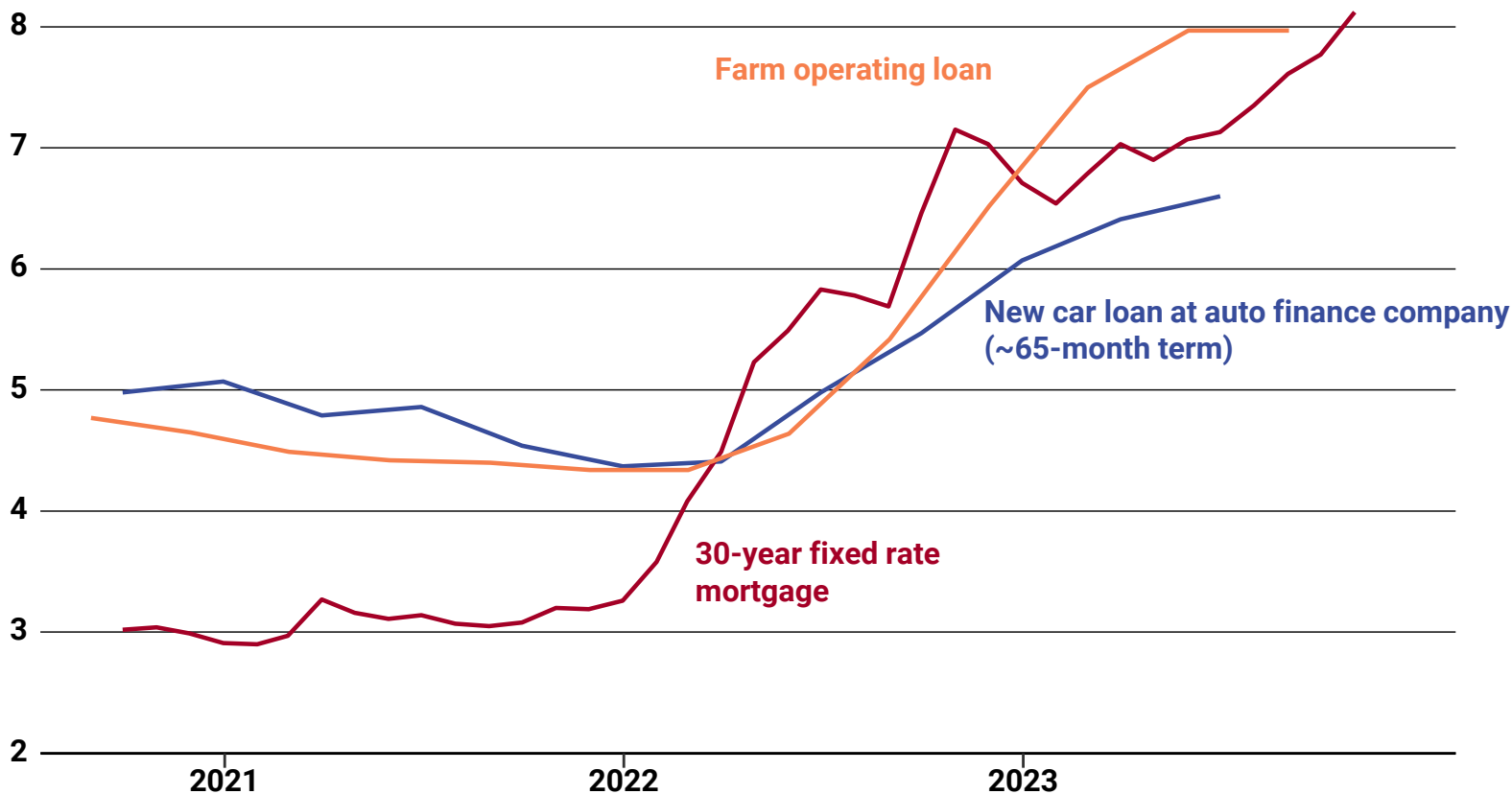


Source: Staff calculations based on Aladangady, Aditya, David Cho, Laura Feiveson, and Eugenio Pinto (2022). "Excess Savings during the COVID-19 Pandemic," *FEDS Notes*. Washington: Board of Governors of the Federal Reserve System, October 21, 2022, <https://doi.org/10.17016/2380-7172.3223>.

Consumer borrowing rates have increased a lot

Consumer Loan Rates

(Percent)

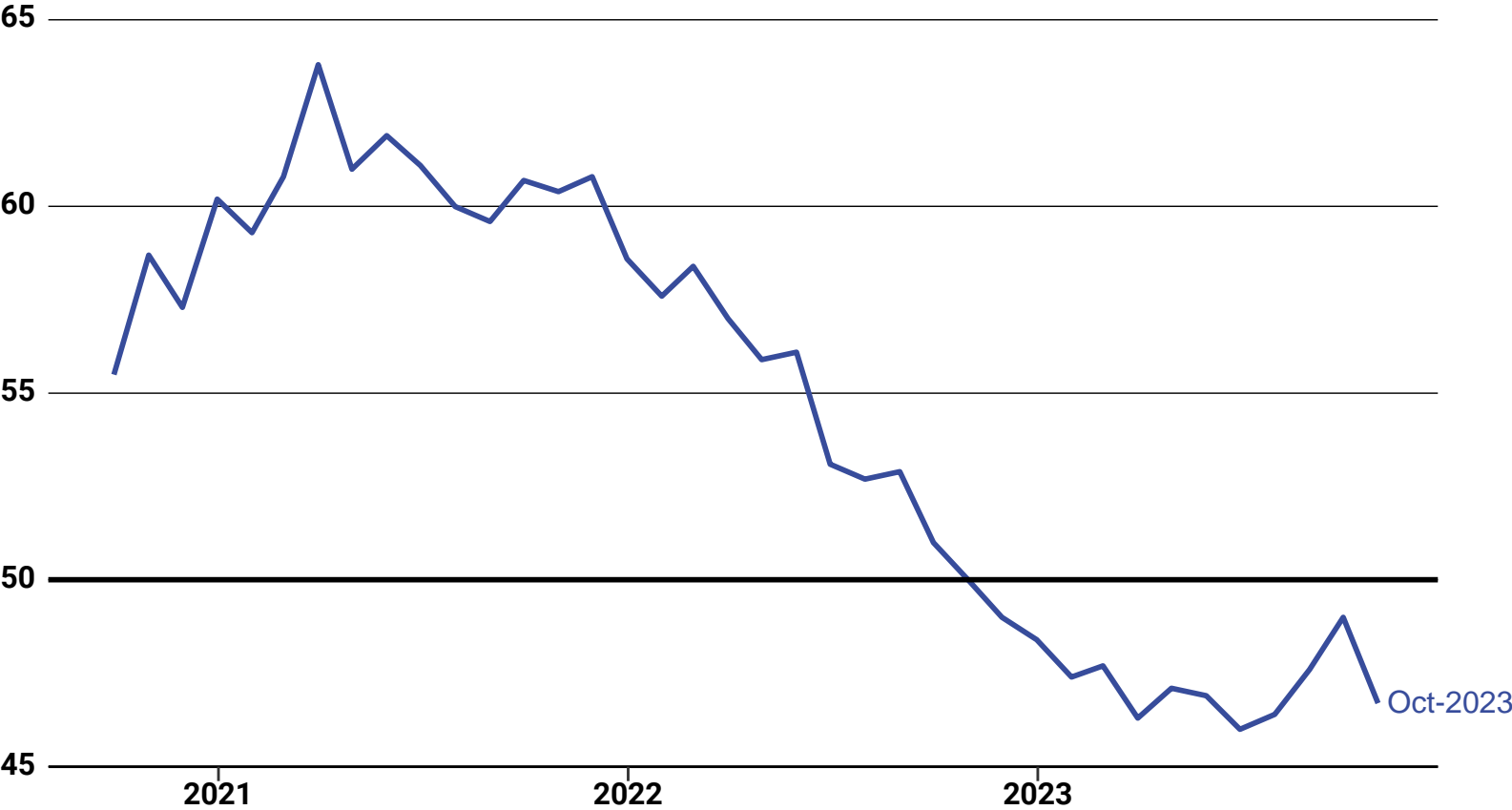


Source: Federal Reserve Board and WSJ via Haver Analytics; Federal Reserve Bank of Chicago

Manufacturing activity still slowing

ISM Manufacturing: PMI Composite Index

(>50 indicates expansion)



Source: Institute for Supply Management via Haver Analytics

Summing up

- **2023 was expected to be a “recession” year, but ended up being pretty good**
 - Forecast: Below-trend growth, unemployment rate increases, and inflation easing
 - Actual: Above-trend growth, continued low unemployment, and a lot of progress on inflation
 - And banking stress, auto strikes, and heightened geopolitical risk
- **What can we expect for 2024? Back to the future.**
 - Current forecasts: Below-trend growth, unemployment rate increases, and inflation continues to ease
 - Could 2024 end up looking like 2023?
 - Supply improvements can’t continue forever, higher rates are hitting households and businesses
 - Labor market is strong, and economy has been surprisingly resilient
- **FOMC will be focused on inflation developments**



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