The Economy and Monetary Policy: Back to The Future?

2023 Midwest Agriculture Conference
Chicago, IL
November 28, 2023

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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...

The 2023 Outlook: A Recession Year

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

Big Banks Predict Recession, Fed Pivot in 2023
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)

[Graph showing consumer sentiment from 2021 to 2023, with Dec-2022 highlighted]

*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

<table>
<thead>
<tr>
<th></th>
<th>GDP</th>
<th>Unemployment Rate</th>
<th>Total PCE</th>
<th>Core PCE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec. 2022 Blue Chip Consensus</td>
<td>0.3</td>
<td>4.4</td>
<td>3.4</td>
<td>3.0</td>
</tr>
<tr>
<td>Year-to-Date</td>
<td>3.0</td>
<td>3.9</td>
<td>2.5</td>
<td>3.3</td>
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- **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)

Why: Labor force participation increased

**Labor Force Participation Rate**

(Percent, SA)

<table>
<thead>
<tr>
<th>Year</th>
<th>Rate</th>
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<tr>
<td>2021</td>
<td>61.0</td>
</tr>
<tr>
<td>2022</td>
<td>61.5</td>
</tr>
<tr>
<td>2023</td>
<td>62.0</td>
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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

Weaker consumer spending to trigger mild recession in 2024
## Back to the future, but with lower inflation

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<td><strong>2024 Blue Chip Median Forecast (Nov. 2023)</strong></td>
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<td>4.3</td>
<td>2.3</td>
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### 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)

- Actual path
- Market path, Nov. 24, 2023

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)

Consumer borrowing rates have increased a lot

**Consumer Loan Rates**
(Percent)

- Farm operating loan
- New car loan at auto finance company (~65-month term)
- 30-year fixed rate mortgage

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 a banking crisis, 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?
    o Supply improvements can’t continue forever, higher rates are hitting households and businesses
    o Labor market is strong, and economy has been surprisingly resilient

• FOMC will be focused on inflation developments