

The Economic Outlook for the U.S. and Michigan for 2018: Implications for Supply Chain Firms

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Right Place Supply Chain Management Conference

March 21, 2018

A Better Than Expected 2017

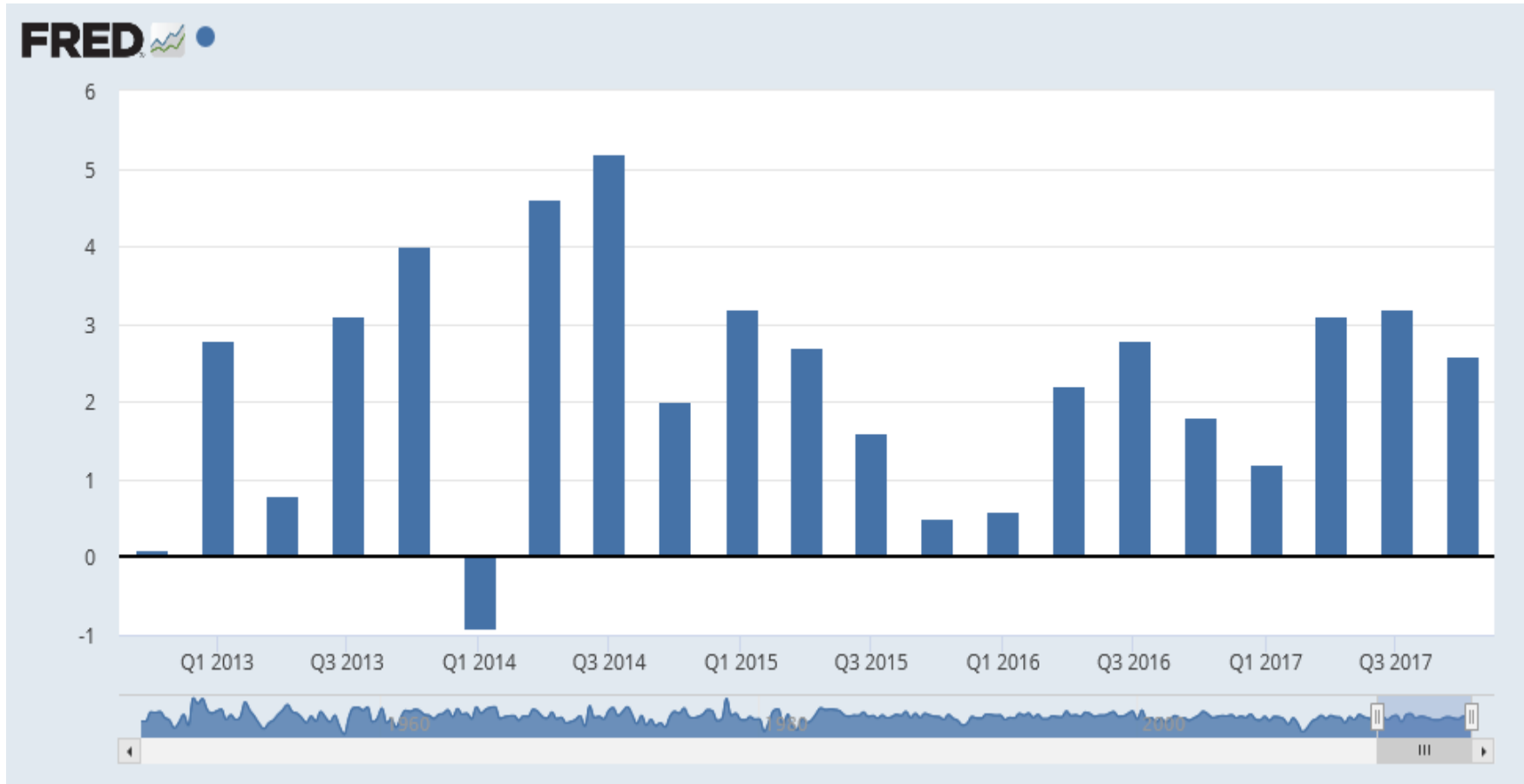
“ Everything basically went right in 2017

- . Unemployment continued to fall (4.1%)
- . Consumer confidence hit lofty levels
- . Household wealth hit a record (almost \$97 trillion)
- . World economy entered into expansion
- . 2nd and 3rd Quarter GDP exceeded 3%
- . Wages started to rise meaningfully
- . Record stock market levels

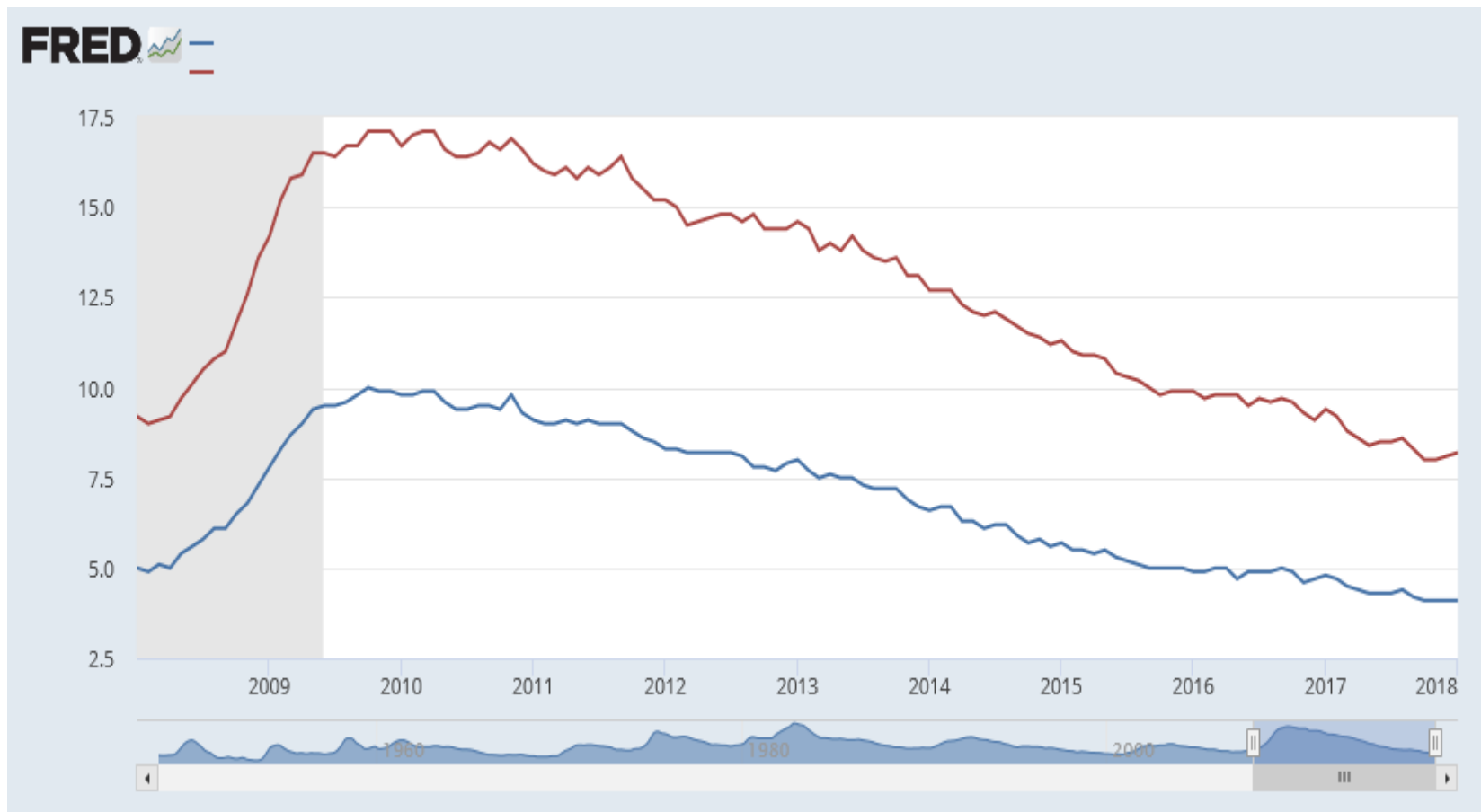
How about 2018?

- “ Plenty of reasons to be optimistic
 - . Economy has momentum
 - . World economic expansion looks likely to continue
 - . The tax stimulus will start to kick in

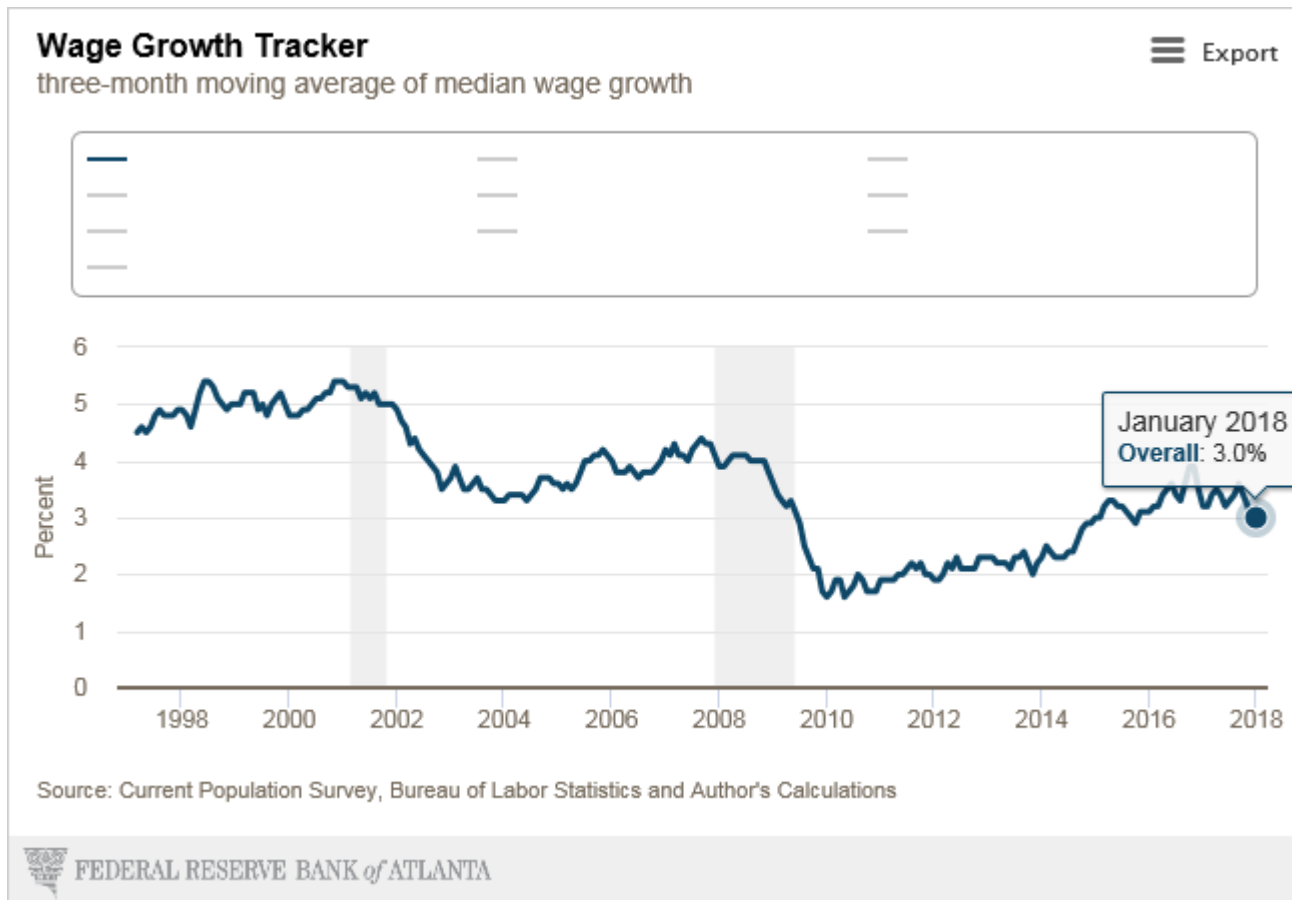
US GDP—above 3% in Q2 and Q3,
estimated at 2.5% in Q4



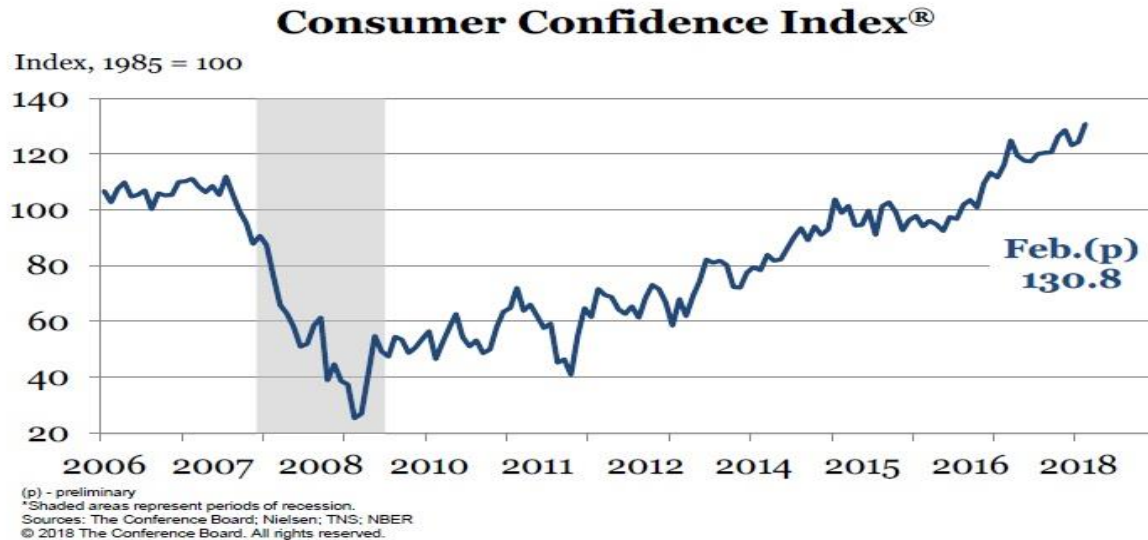
Unemployment has fallen to 4.1% and the broader U-6 measure has dropped to near pre-recession levels (8.2%)



Atlanta Fed Wage Tracker, 3%, January 2018



Consumer Sentiment Strong and Rising— February report was strongest since 2007



IMF World Economic Outlook Projections (January, 2018)

	2016	2017	2018	2019
World Output	3.2	3.7	3.9	3.9
Advanced Economies	1.7	2.3	2.3	2.2
--U.S.	1.5	2.3	2.7	2.5
-- <i>Euro area</i>	1.8	2.4	2.2	2.0
--Japan	0.9	1.8	1.2	0.9
--UK	1.9	1.7	1.5	1.5
--Canada	1.4	3.0	2.3	2.0
Emerging and Developing	4.4	4.7	4.9	5.0
--Russia	-0.2	1.8	1.7	1.5
--China	6.7	6.8	6.6	6.4
--India	7.1	6.7	7.4	7.8

The value of the stock market has reached new highs and showed resilience after recent volatility



CBOE 3-month volatility index-1 year performance



How to think about the tax stimulus?

- “ Will clearly boost growth but how much and for how long?
- “ The final version loads a significant amount of stimulus into 2018 (\$200 billion)
 - . Cuts are immediate
 - . Overseas cash repatriation
 - . Full expensing of capital
- “ However, with tight labor markets and a surge in demand, will inflation pick up?
- “ Estimates of **boost to GDP range from 0.3% to over 1%**

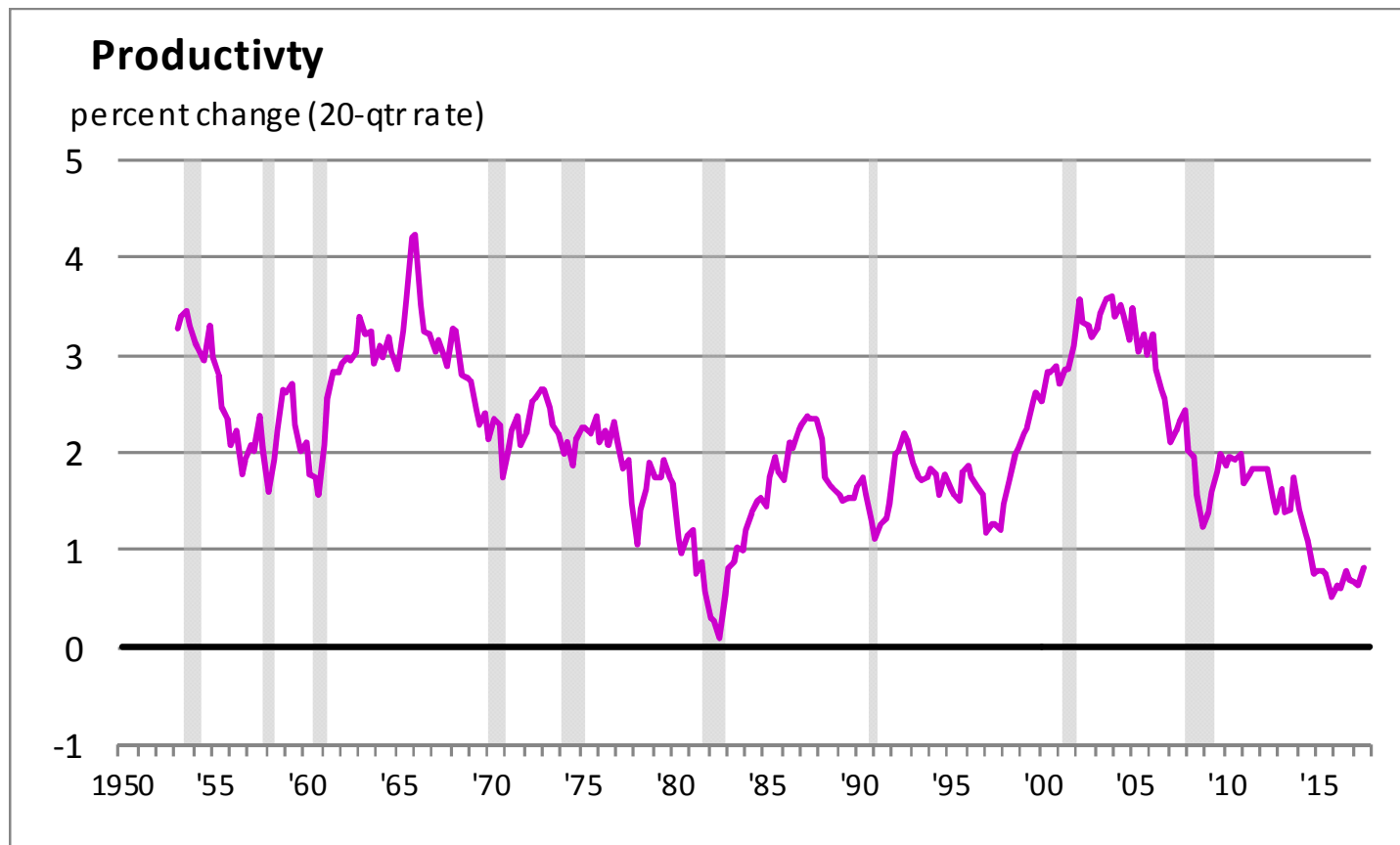
More on the tax package

- “ A Barclays research report suggests that (on average) S & P 500 companies will see **effective tax rates drop from 26% to 20.7%** with rise in earnings per share of 6.3%.
- “ **Repatriation** (if the experience from 2004 is a guide) may lead to significant acquisition binge.
- “ The dollar will strengthen if the interest rate spreads vs other currencies widen.
- “ **Biggest economic impact may be on interest rates.** Many predict 10 year treasury yields will hit 3%.

In the long run...

- “ Still a balancing act...unlikely that the tax package doesn't expand the deficit. As such we are pulling growth forward from future years.
- “ **Timing of fiscal stimulus isn't ideal**...tight labor market and rising interest rates
- “ **Underlying economic factors still suggest reduced potential growth** in the future...bad demographics, productivity rut.
- “ In the long run, for the cuts **to be most effective, productivity has to surge**. Businesses need to invest and expand, not just buy back stock or increase dividends.

This is the indicator to watch ñ given population trends,
productivity is the key to growth in the future



Is inflation lurking? 10 year US Treasuries headed to 3%?



The Current Forecast

- “ Last FOMC (December, 2017) central tendency projection for **GDP growth in 2017 is 2.4% to 2.5%**. **Long-run 1.8% to 2.0%**. Growth in 2018 at 2.2% to 2.6%. (Both revised up from September)
- “ Inflation still running below the 2% target for PCE. FOMC forecast **has PCE at 1.6% to 1.7% in 2017**. **Long-run estimate is at 2%, with 2018 projected at 1.7% to 1.9%**.
- “ FOMC forecast has **unemployment 4.1% (2017), 3.7% to 4.0 % (2018)**. **Long-run—4.5% to 4.8%**
- “ Fed policy. December, 2017 was the fifth quarter point increase since 2008 (1.25% to 1.50% Fed Funds rate). Big issue will be the pace of potential future increases to get to “normalization” (now 2.8% to 3.0%). Expectation is for 3 possible rate hikes in 2018. Other significant news was plan for reducing the Fed balance sheet.

Turning to Michigan

- “ State has been on something of a roll...8 straight years of payroll employment growth.
- “ Some evidence that the pace of employment growth will slow...particularly as related to autos.
- “ RSQE (U of Michigan) “With less labor market slack than earlier in the recovery, we see 2017 as the new normal for Michigan over our forecast period: steady job growth, low unemployment, tame inflation and an economy that continues to diversify. All in all, we see that profile as a winning combination for Michigan”.

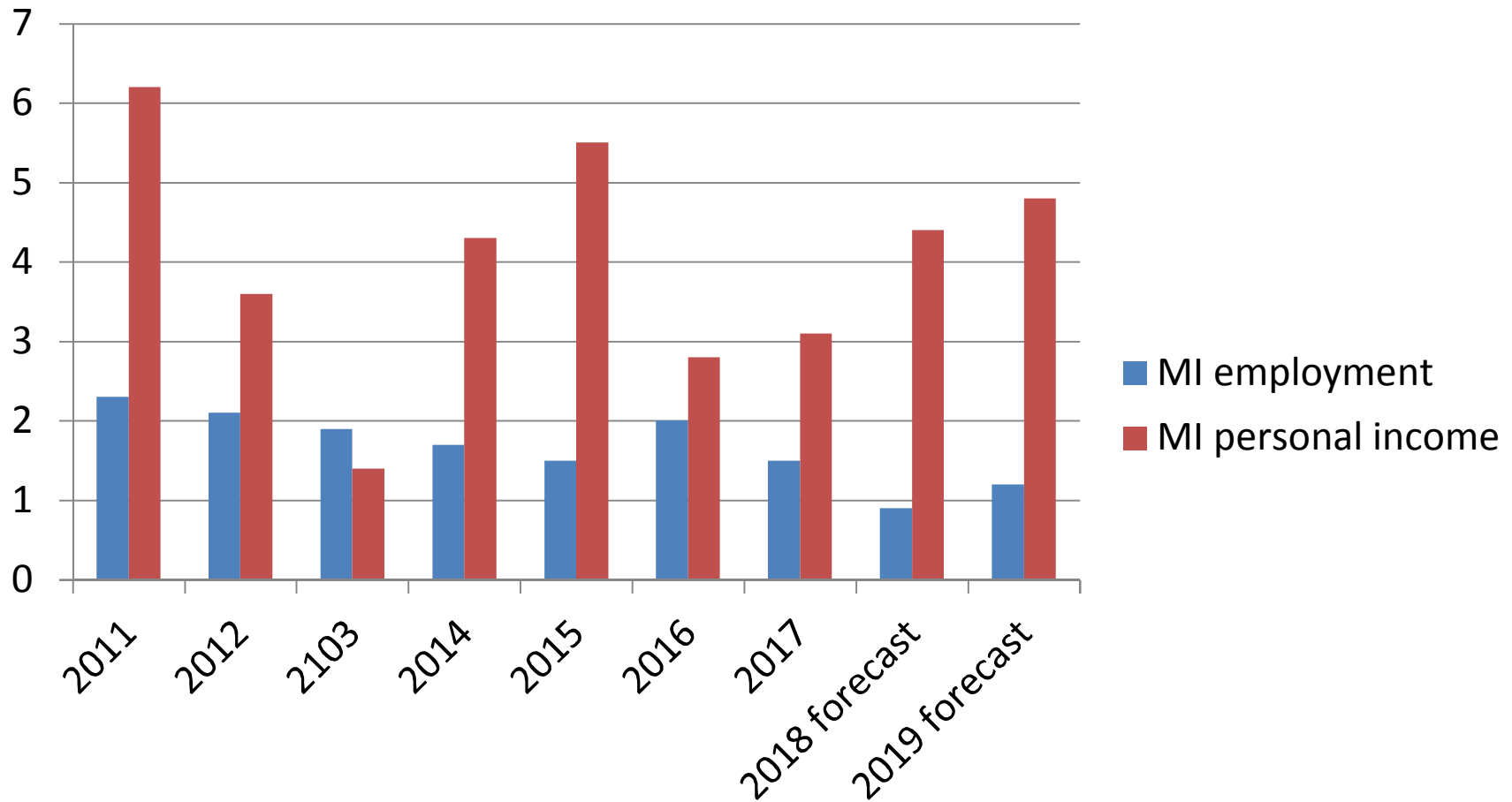
What has gone right for Michigan?

- “ Manufacturing and professional and business services boosted Michigan coming out of the recession. From 2009 to 2014, 1/3 of all job gains for Michigan were in manufacturing. However that has slowed to only 1/12 from 2014 to 2017.
- “ Professional and business services has performed well. From 2009 to 2016, 30% of the jobs added were in this sector. Forecast is for this to increase to 40% of jobs added from 2018 to 2019.

Risks to Michigan

- “ A sharper **auto slowdown** than anticipated (clear risk to supply chain firms focused on auto)
- “ **NAFTA** unwind (export oriented manufacturing suppliers may be impacted)
- “ **Local government** fiscal conditions—government employment (until last year) had declined for 13 straight years.
- “ **No workers**—labor shortage stunts growth

RSQE employment and personal income



Source: RSQE Forecasts, University of Michigan, "The Michigan Economic Outlook for 2018-2019"

Job Recovery—U.S. and Midwest

(through December, 2017)

	Recovery Rate (% of jobs recovered since the end of the recession)
Illinois	119.1
Indiana	164.0
Iowa	252.9
Michigan	144.4
Wisconsin	168.0
U.S.	224.5

Michigan Job Recovery vs the US

(December, 2017)

Michigan

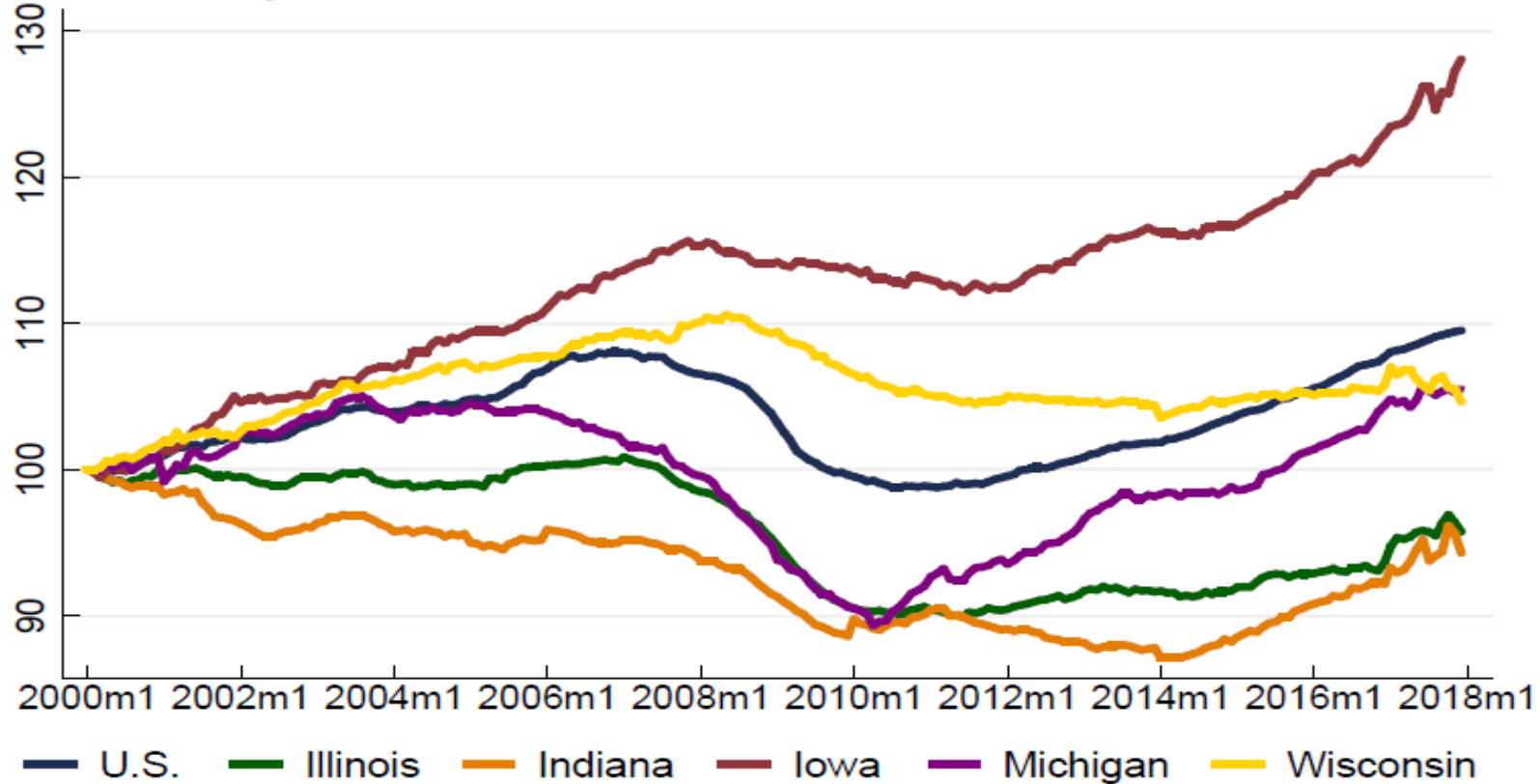
U.S.

	Losses during recession (in 000s)	Performance during the recovery (in 000s)	Recovery rate	Losses during recession (in 000s)	Performance during the recovery (in 000s)	Recovery rate
All industries	-407	587	144.4	-7,393	16,588	224.5
Construction	-37	39	105.1	-1,534	1,065	69.4
Education, Health	7	64	n/a	689	3,775	n/a
FIRE	-15	28	179.7	-461	688	149.2
Government	-3	-32	n/a	200	-252	n/a
Information	-5	2	37.0	-228	-17	-7.5
Leisure	-25	62	244.4	-474	3,137	661.8
Manufacturing	-163	174	107.2	-2,020	814	40.3
Other services	-7	7	87.8	-144	453	314.6
Prof. and Business Svs.	-91	177	195.7	-1,615	4,235	262.2
Trade, Transport and Utilities	-68	68	99.6	-1,806	2,690	149.2

Michigan (purple) Finance Sector Recovery

Finance, Insurance, and Real Estate

Index: January 2000=100

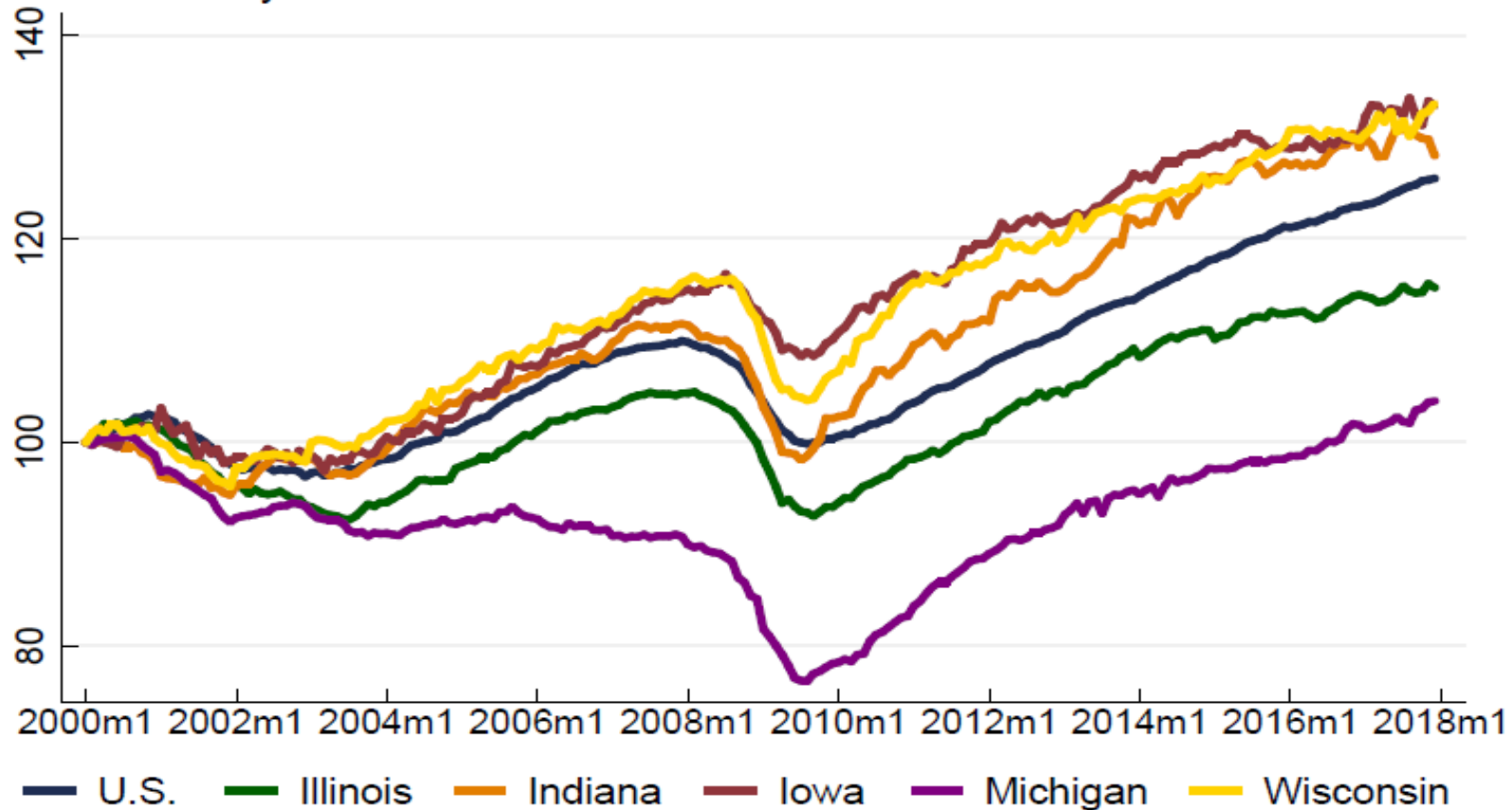


Sources: Data from the Bureau of Labor Statistics accessed via Haver Analytics.
Last observation is December 2017.

Michigan (purple), Professional and Business Services Recovery

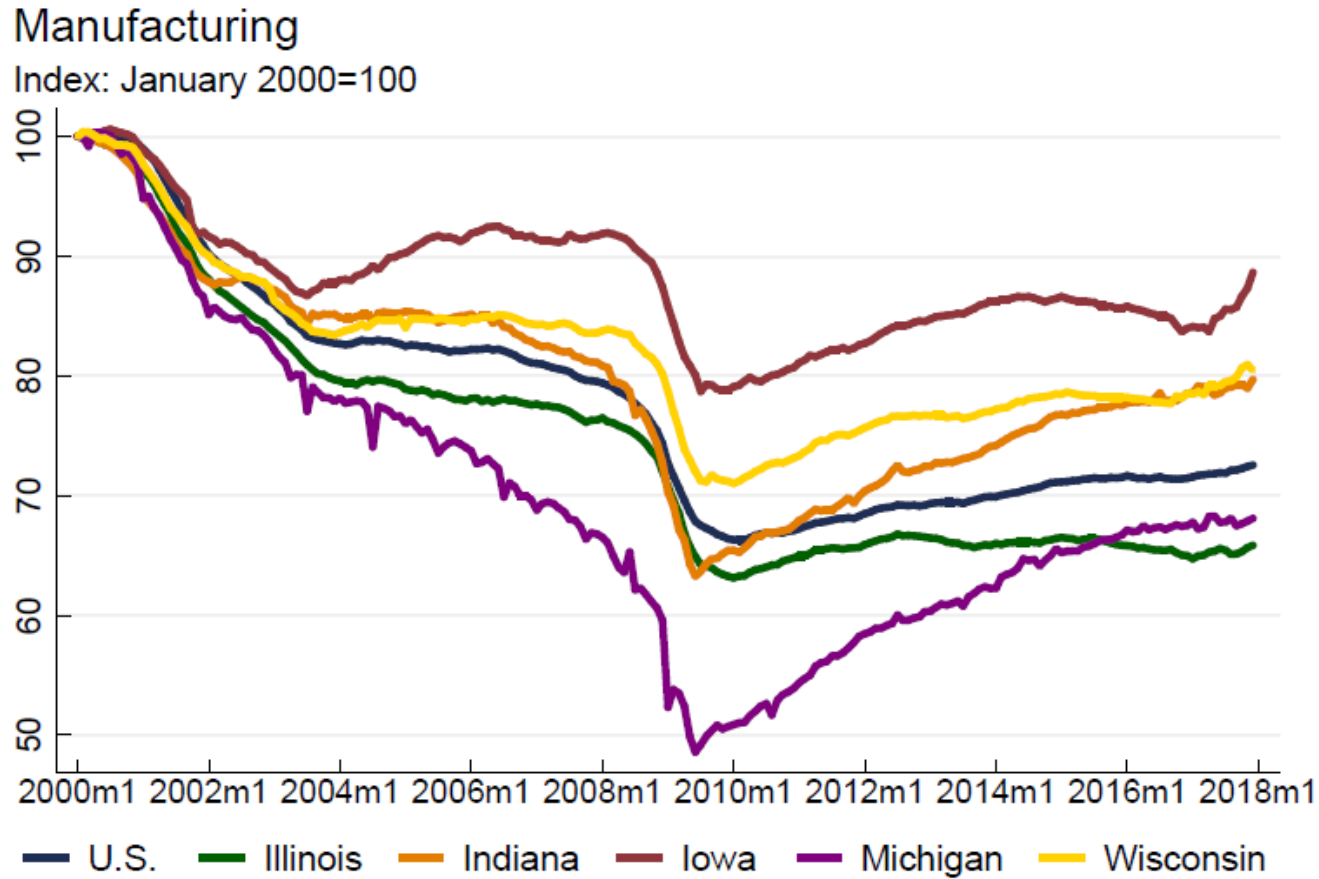
Professional and Business Services

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Michigan (purple) Manufacturing Recovery



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Questions?

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