

# Economic Outlook

Mild Recession Is Most Likely 2023 Outcome as Fed Continues to Tighten Aggressively

**Augustine Faucher**  
Chief Economist  
The PNC Financial Services Group

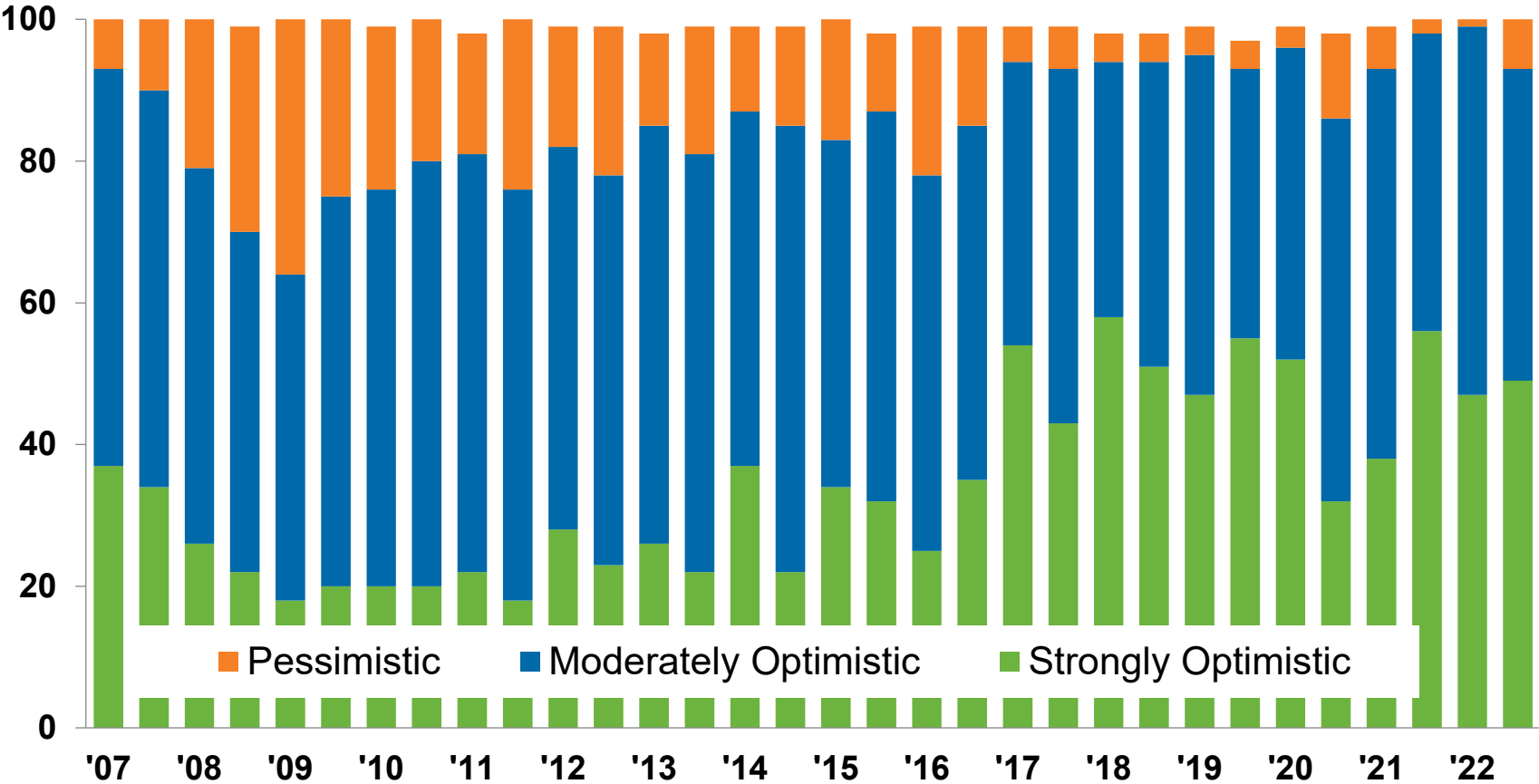
Midwest Economic Forecast Forum  
January 12, 2023



# Small Businesses Were Feeling Optimistic in the Fall...



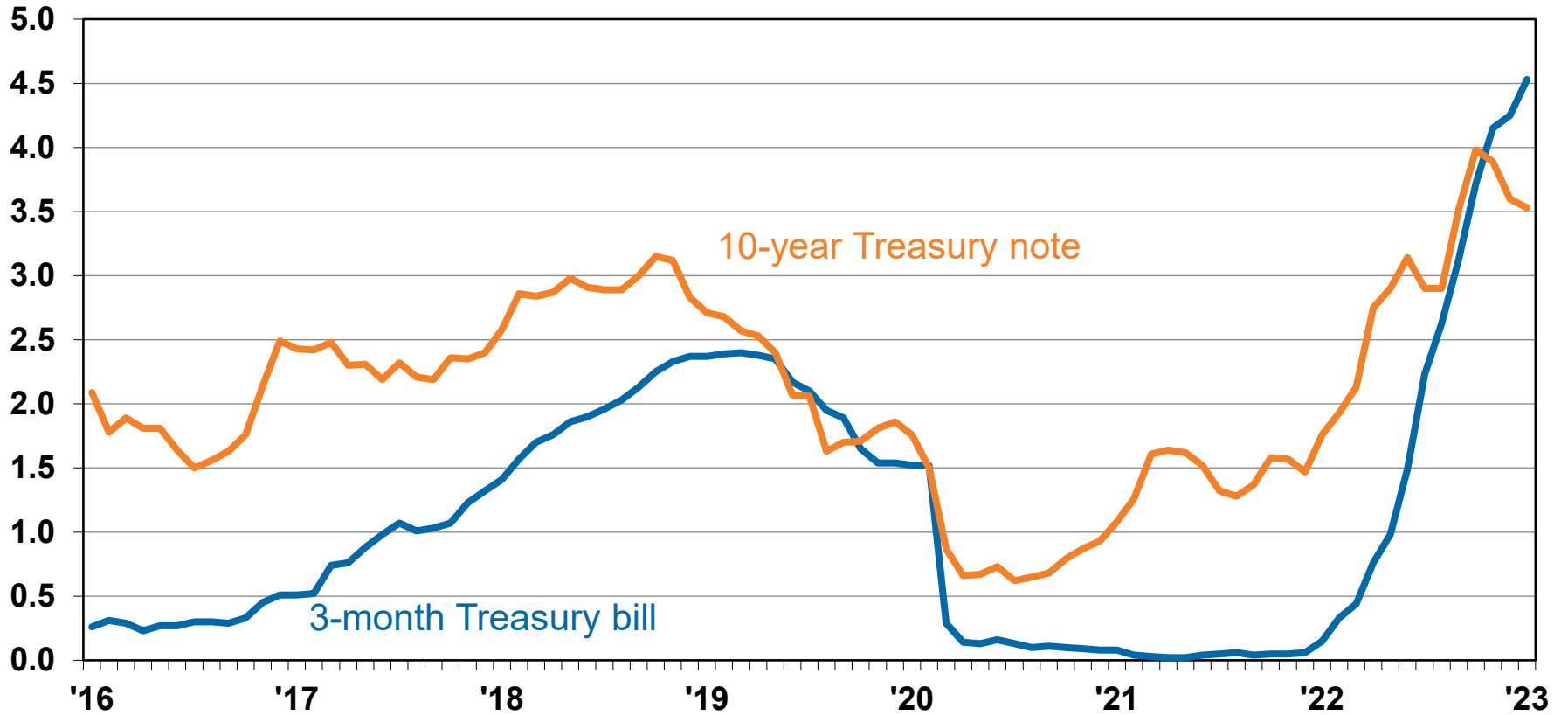
Expectations for own company's prospects, next 6 months, %



Source: PNC

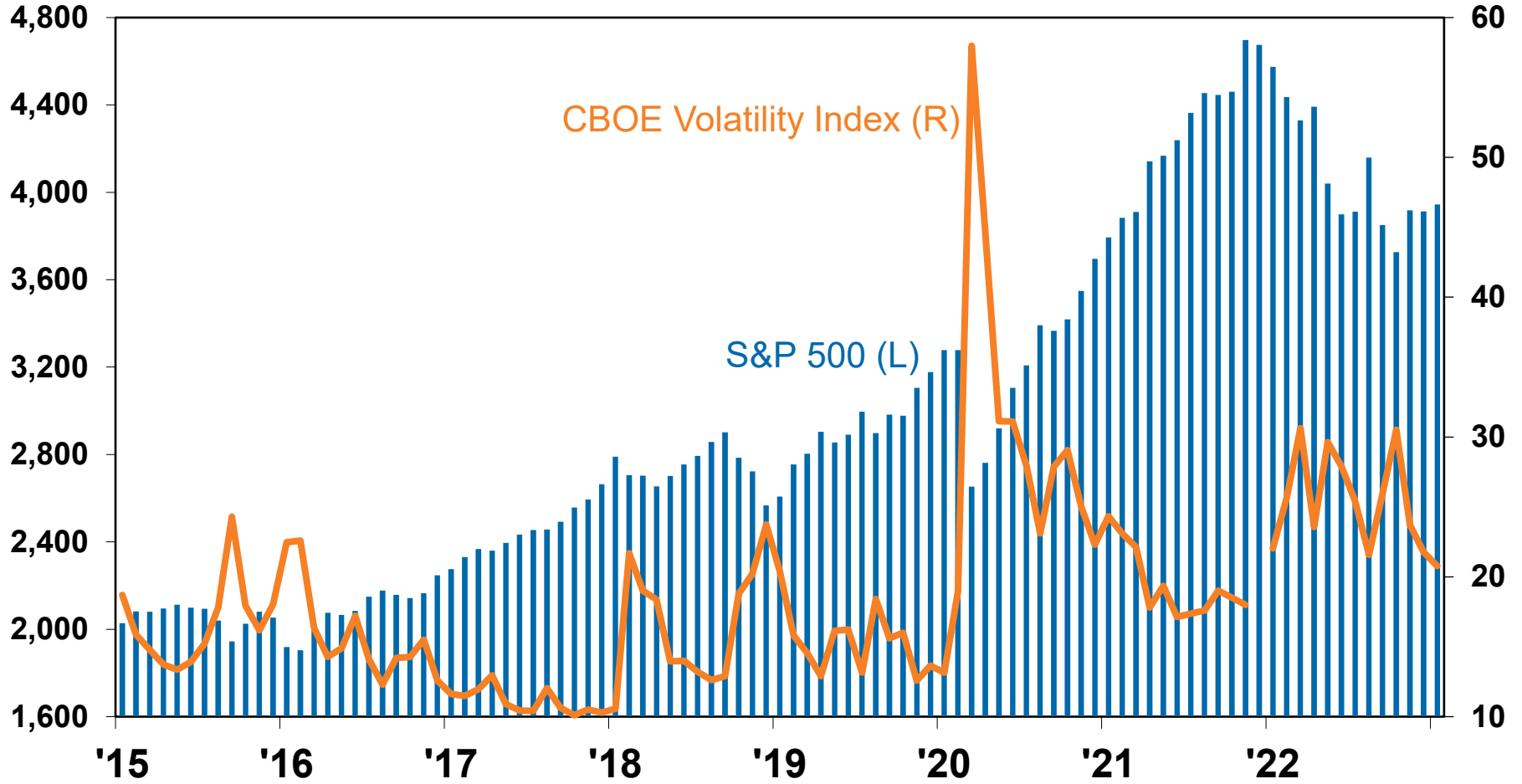
# ...But Interest Rates Are Increasing Across the Board...

Yield, %



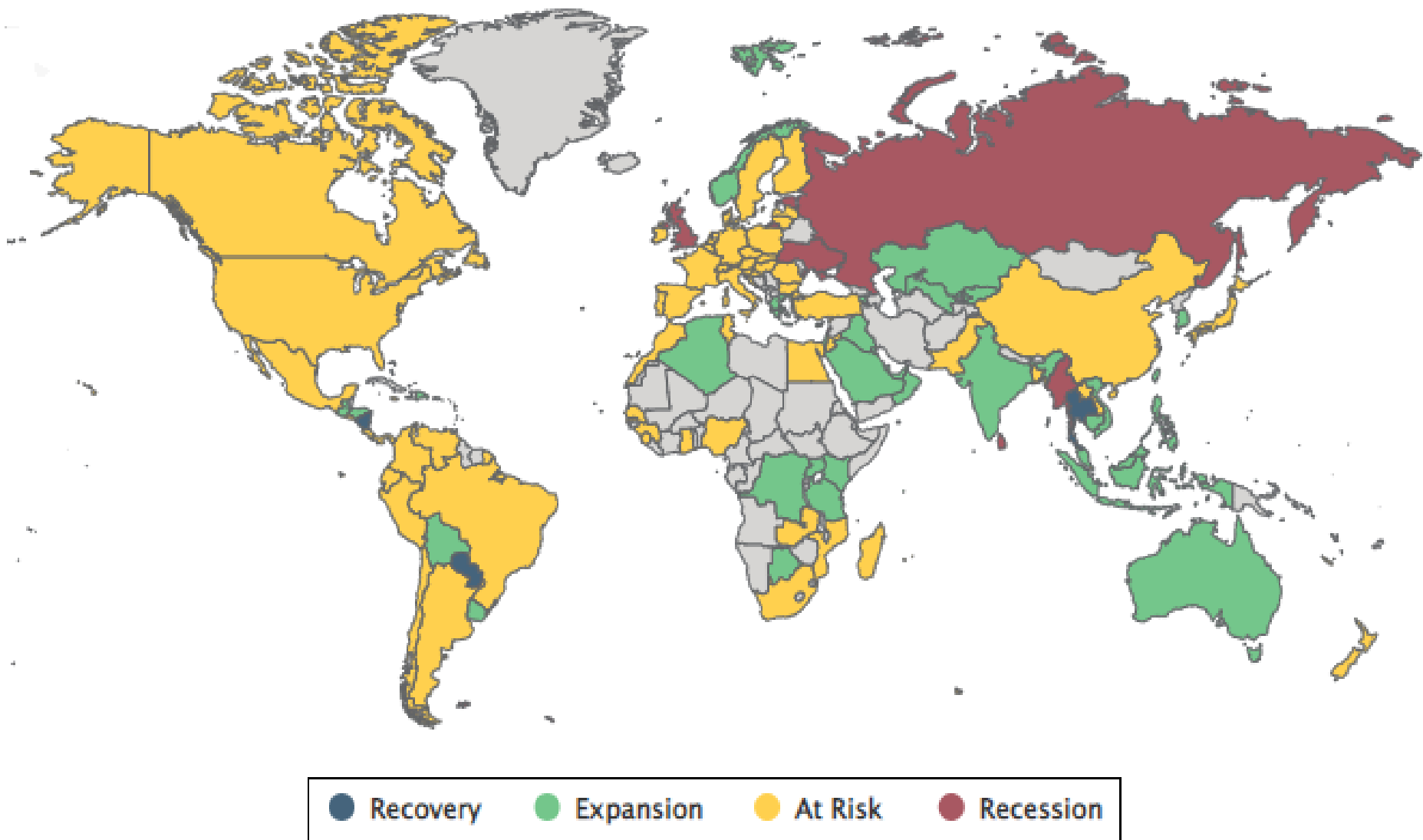
Source: Federal Reserve Board

# ...And Investors Are Nervous



Source: S&P; CBOE

# The Global Economy Is in Trouble

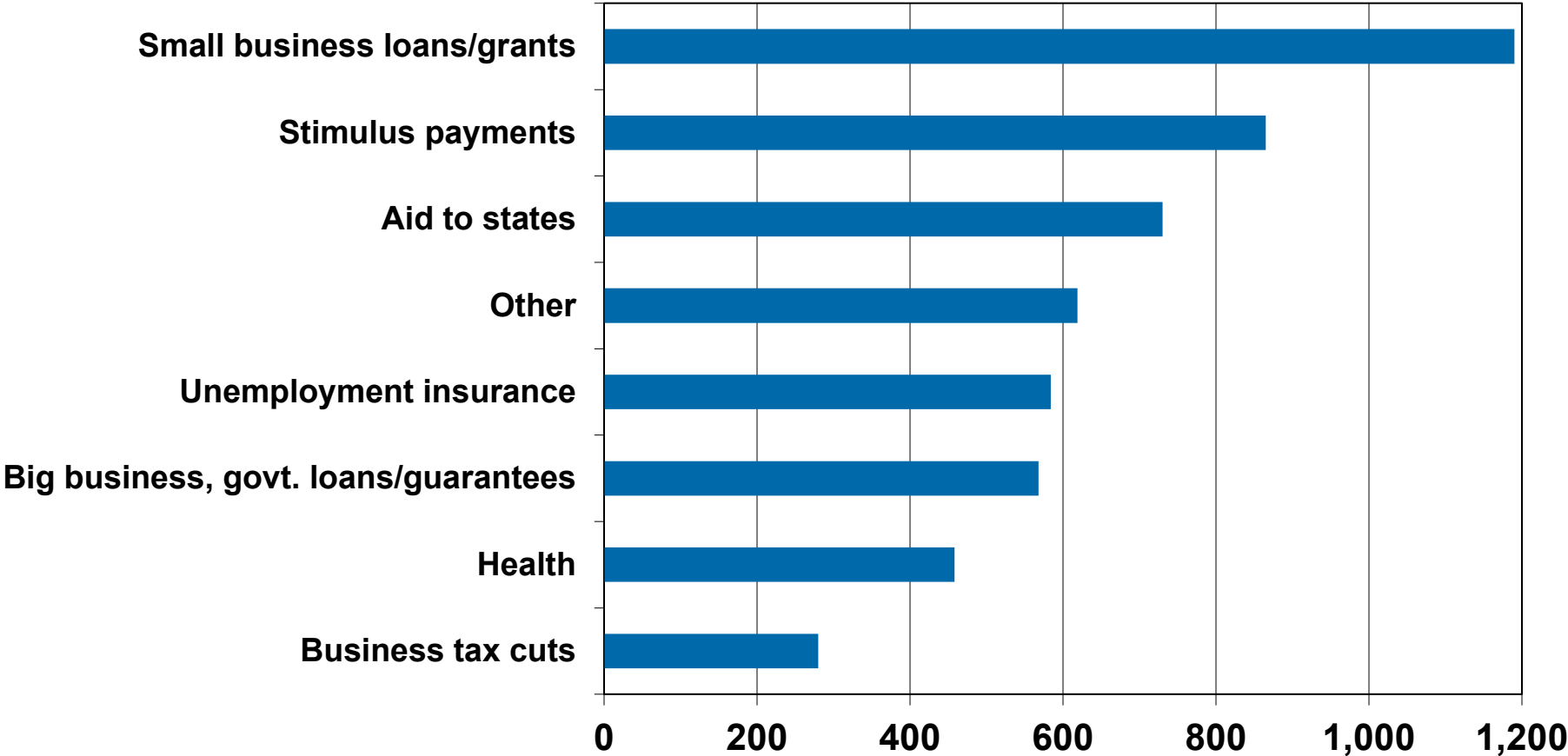


Source: Moody's Analytics

# Stimulus of About One-Quarter of GDP



CARES, Paycheck Protection Program and Health Care Enhancement, Consolidated Appropriations Plan, and American Rescue Plan Acts, spending, \$ bil

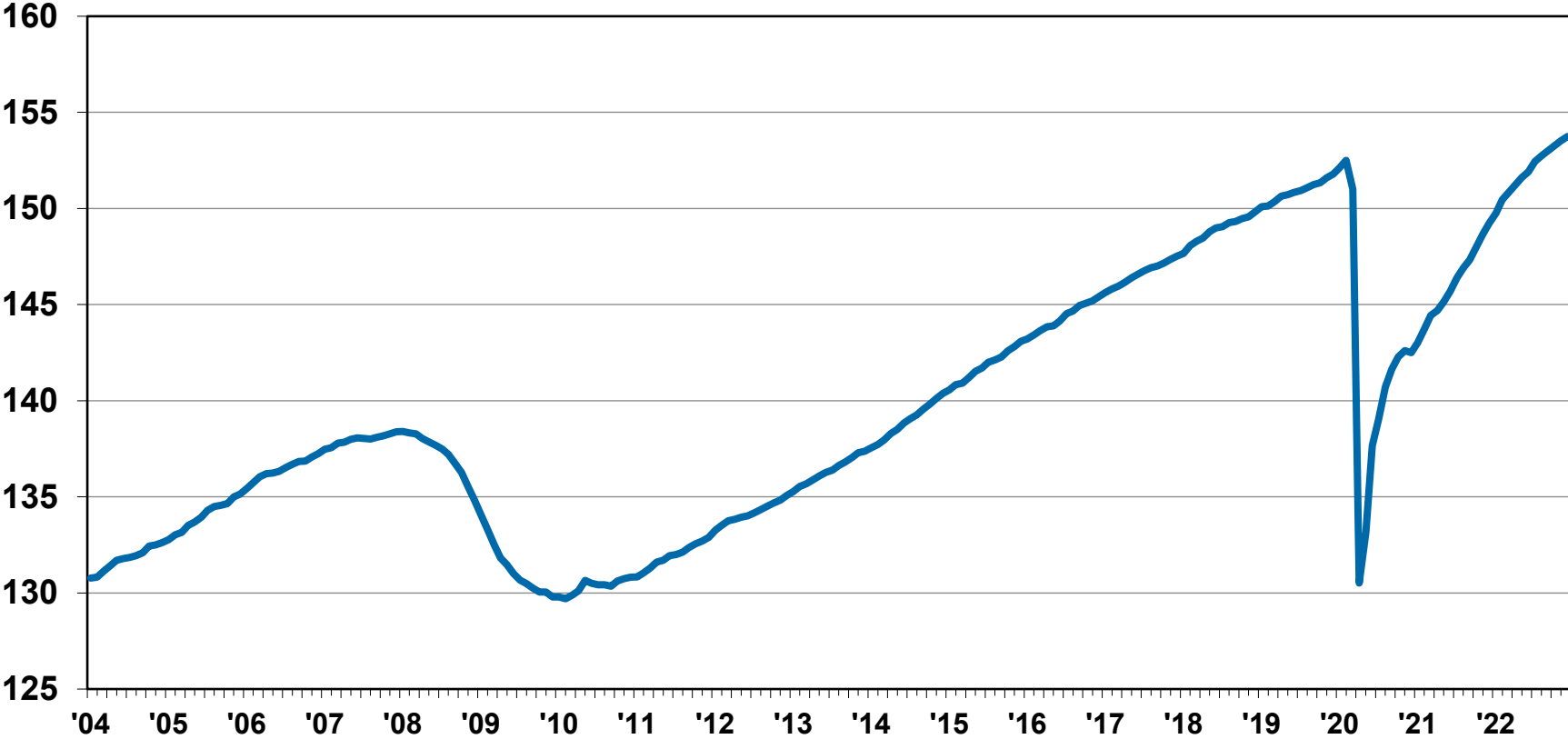


Sources: CBO, Moody's Analytics, PNC

# Employment Has Fully Recovered From the Pandemic



Establishment employment, mil

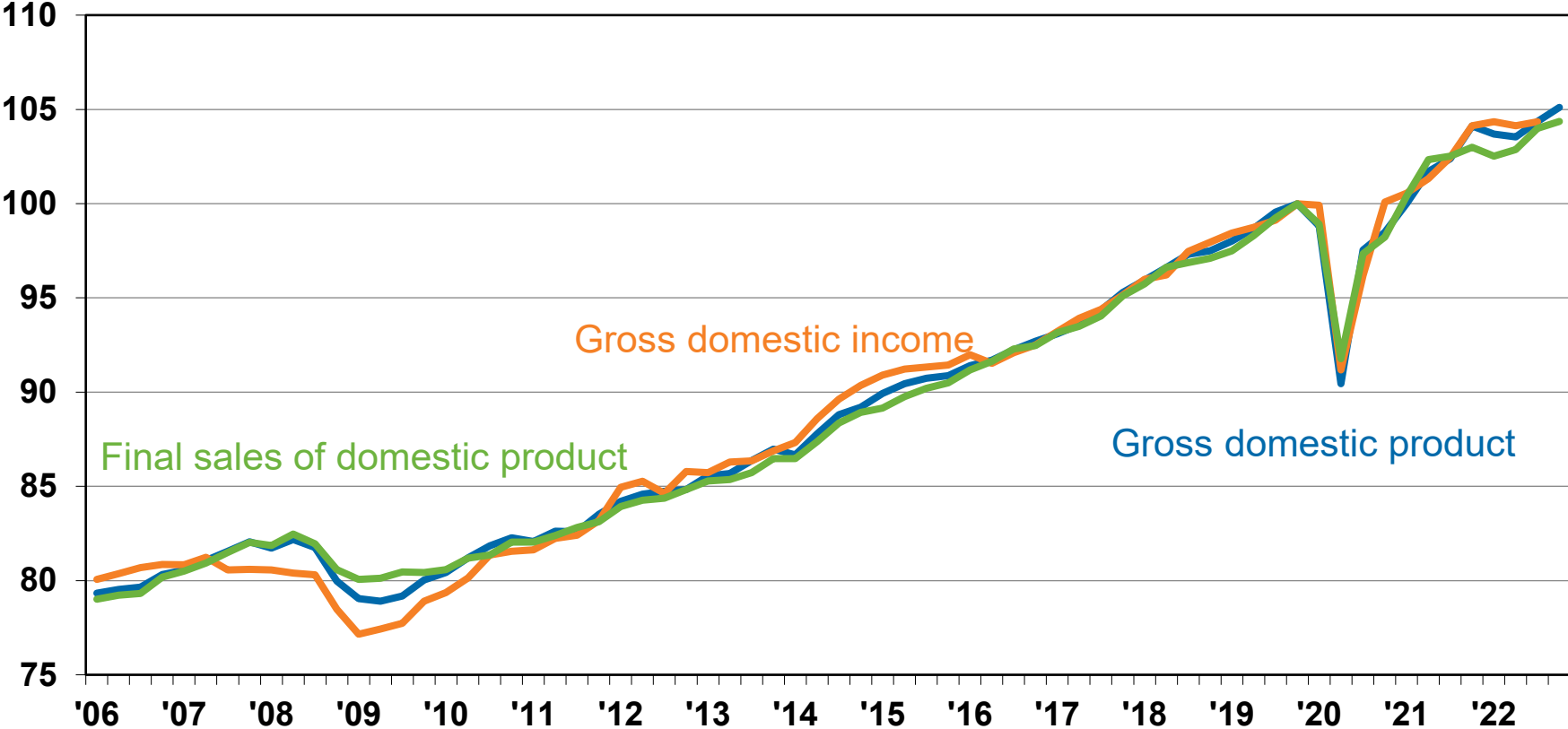


Source: BLS

# Economic Activity Now Above Pre-Pandemic Peak...



Real, index, 2019Q4=100



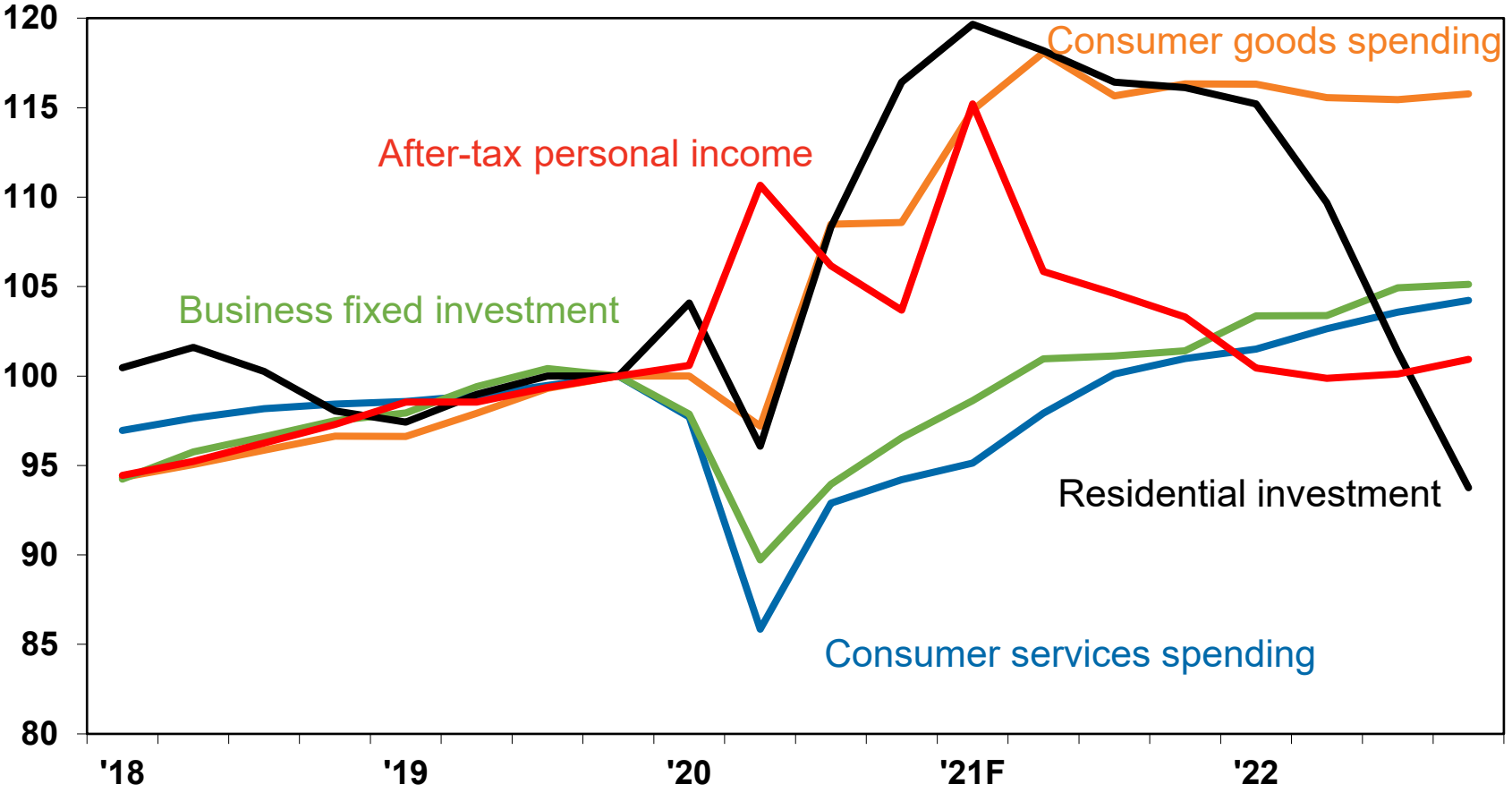
Source: BEA



# ...But That Obscures Big Shifts in Activity



Real, index, 2019Q4=100

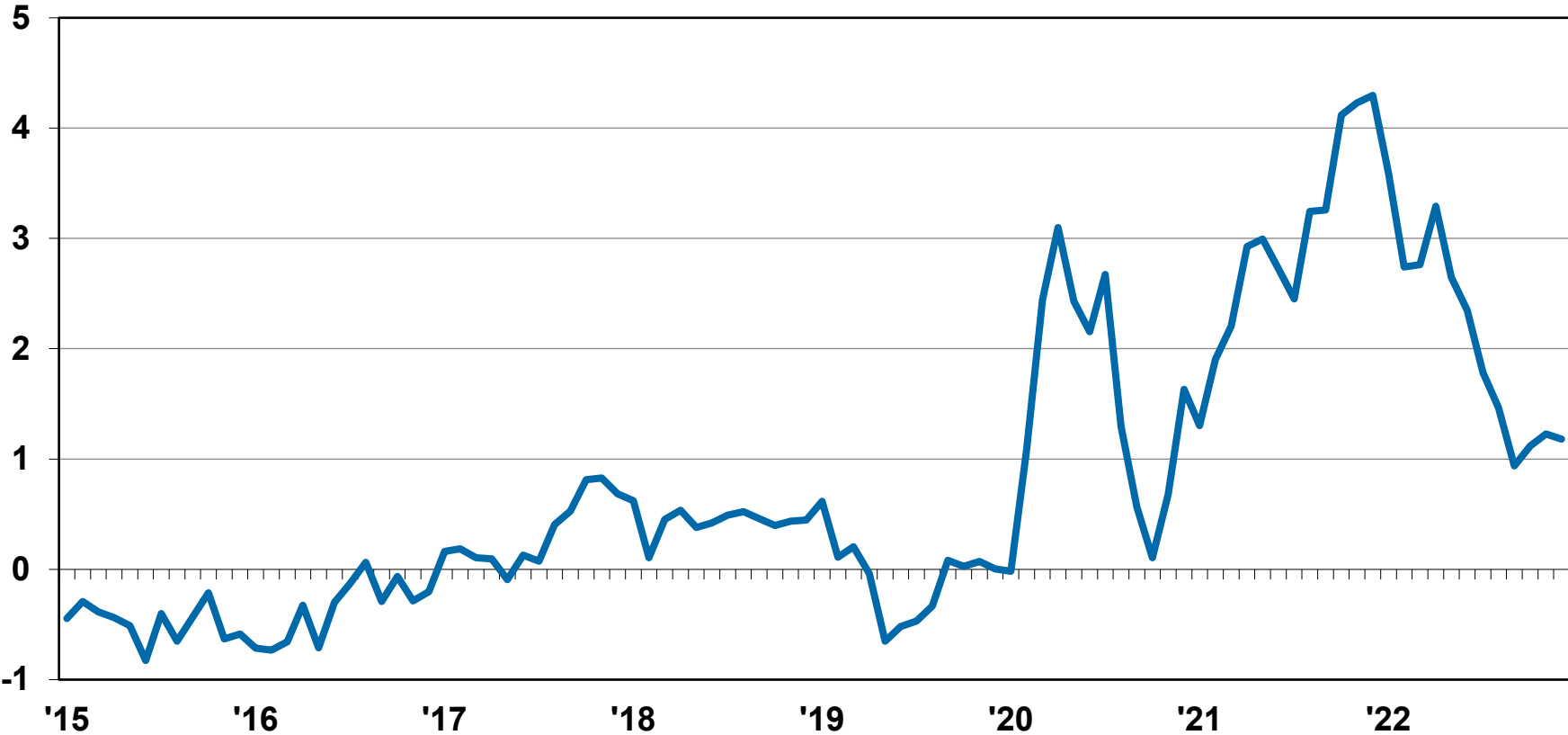


Source: BEA

# Global Supply Chain Pressures Elevated, But Lower



Global Supply Chain Pressure Index, standard deviations from average value

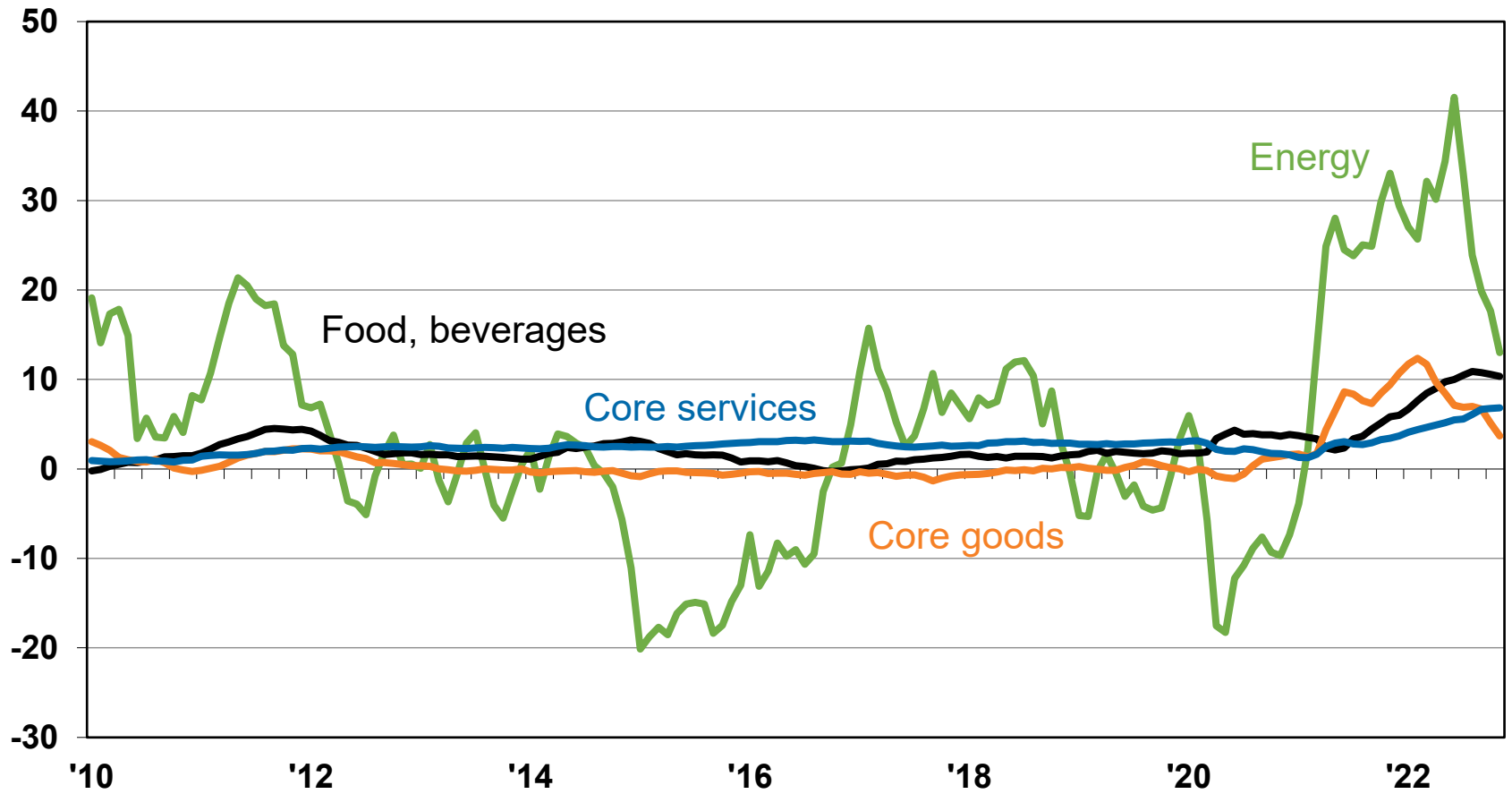


Source: New York Fed

# Acceleration in Core Services Inflation Is a Big Concern



Consumer price index, % change year ago

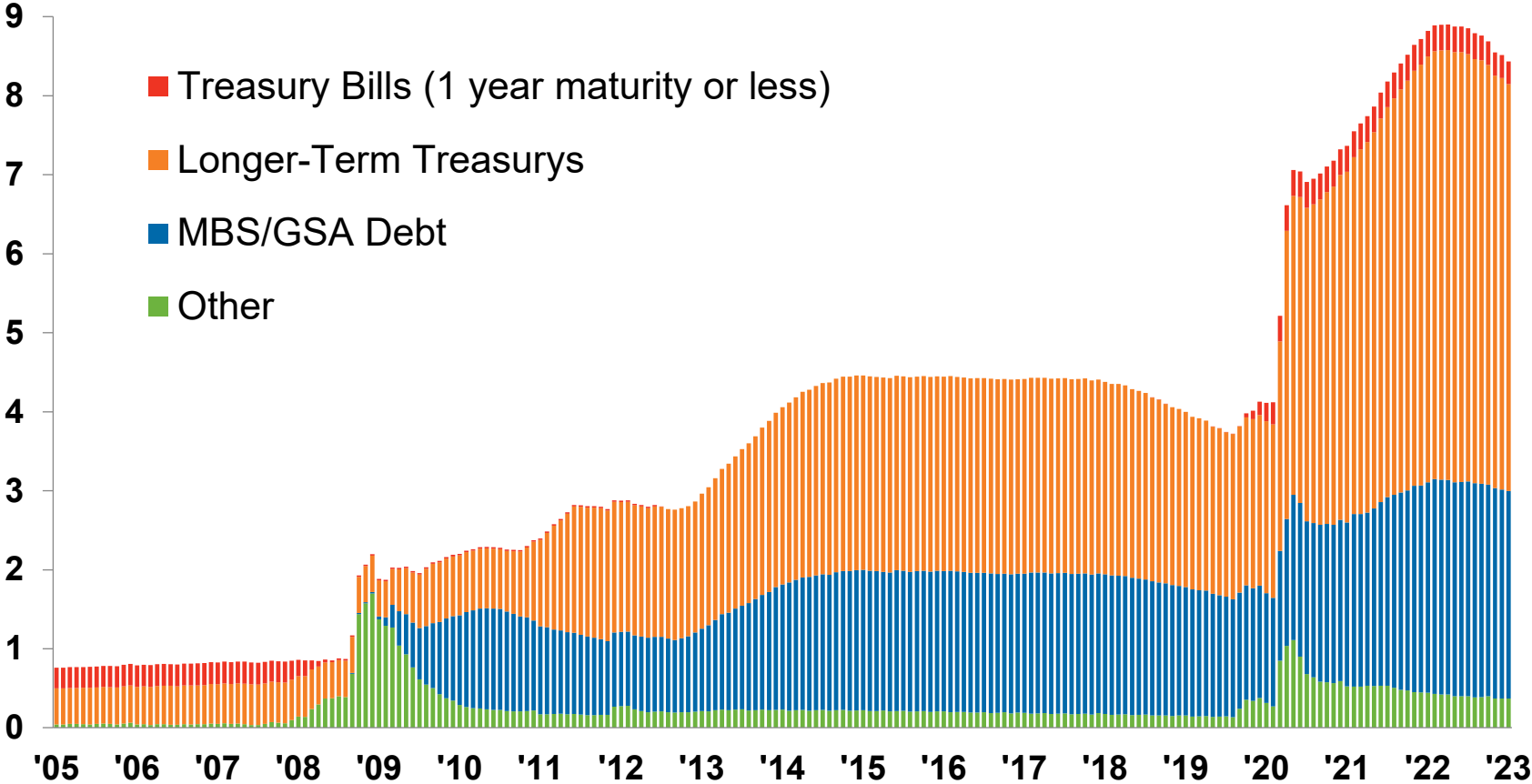


Source: BLS

# Fed Is Shrinking Its Balance Sheet...

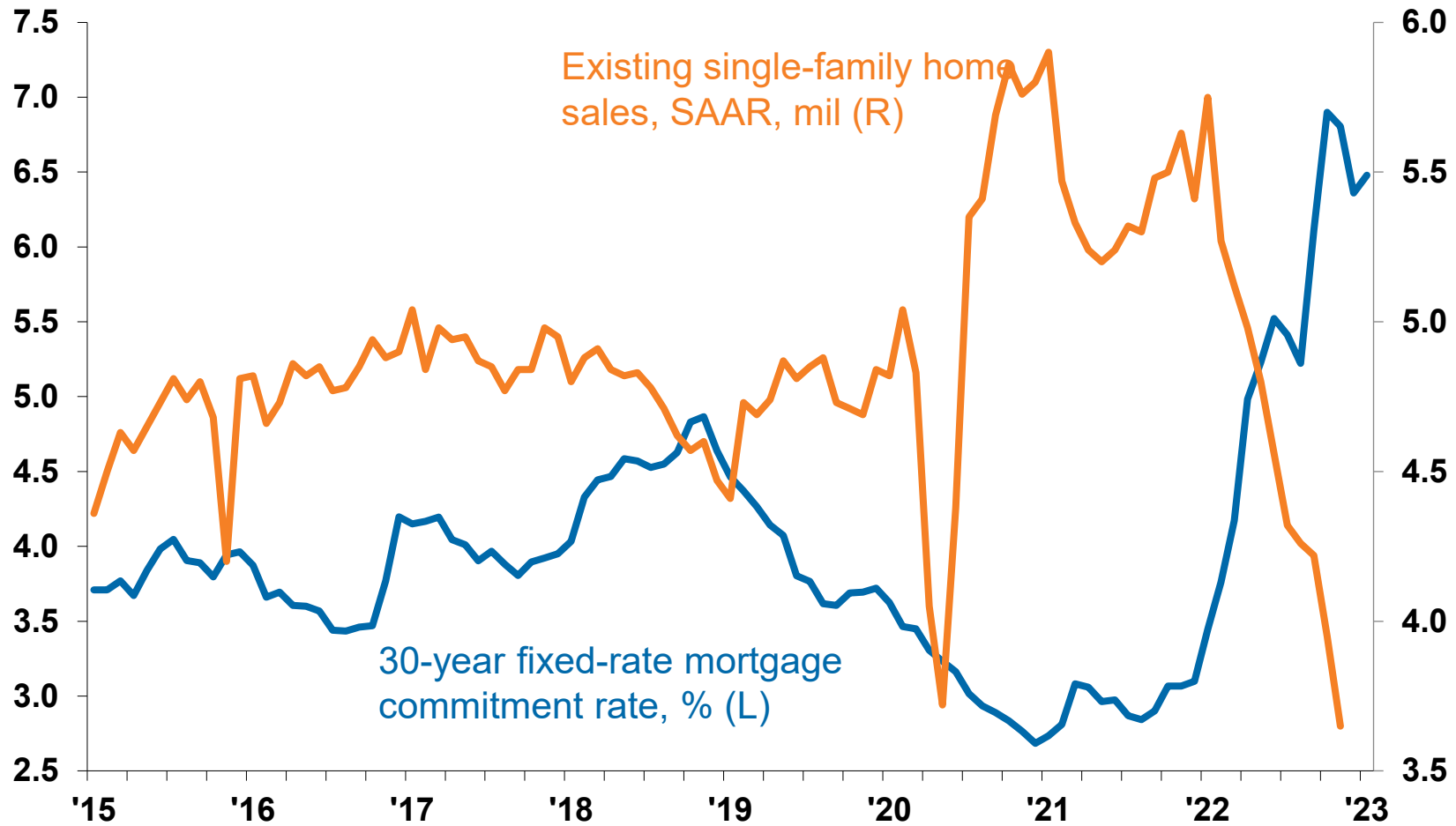


Federal Reserve assets, \$ tril



Source: Federal Reserve Board

# ...And the Big Jump in Mortgage Rates Is Already Weighing on the Housing Market

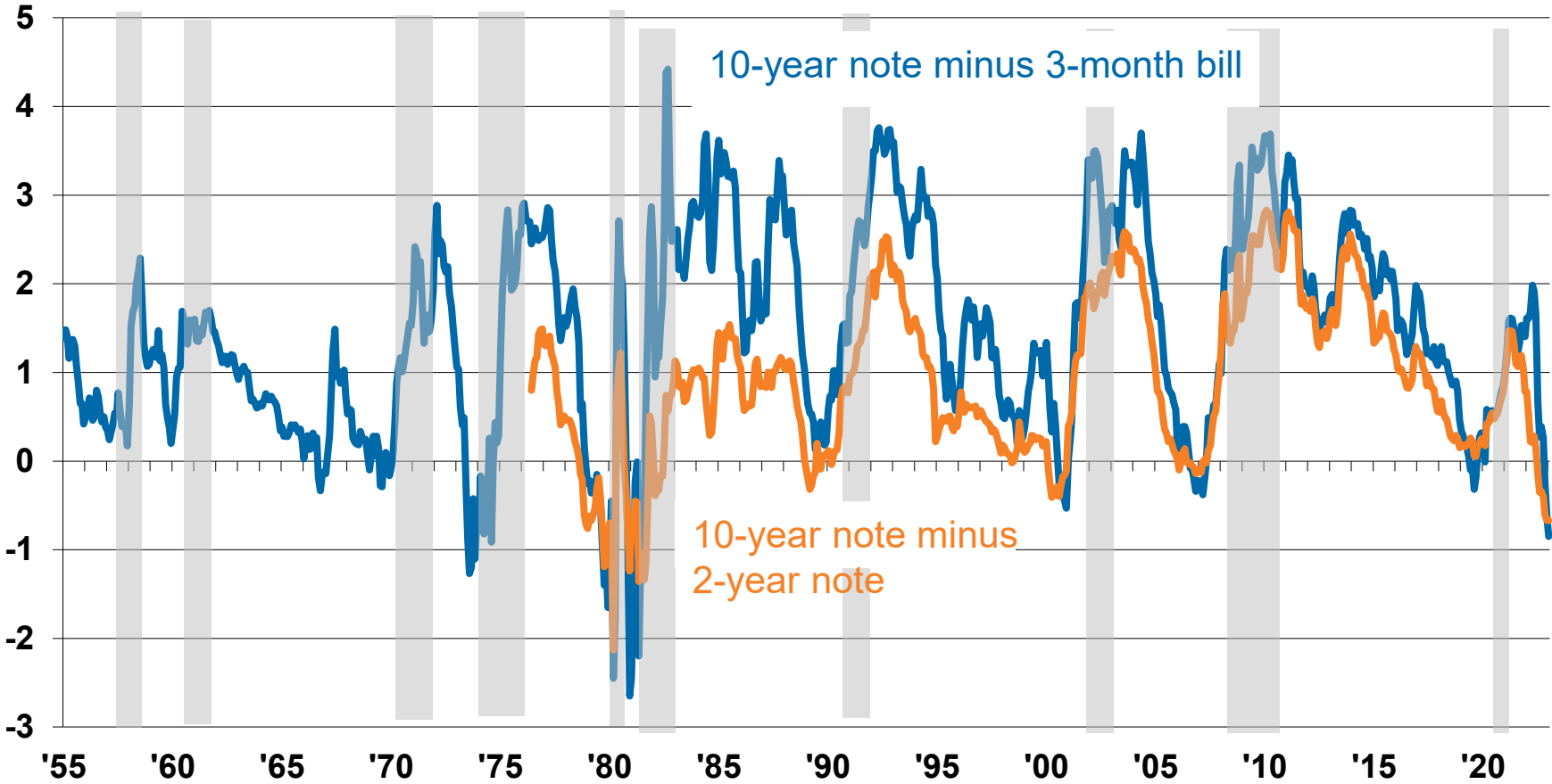


Sources: Freddie Mac, National Association of Realtors

# Yield Curve Has Inverted

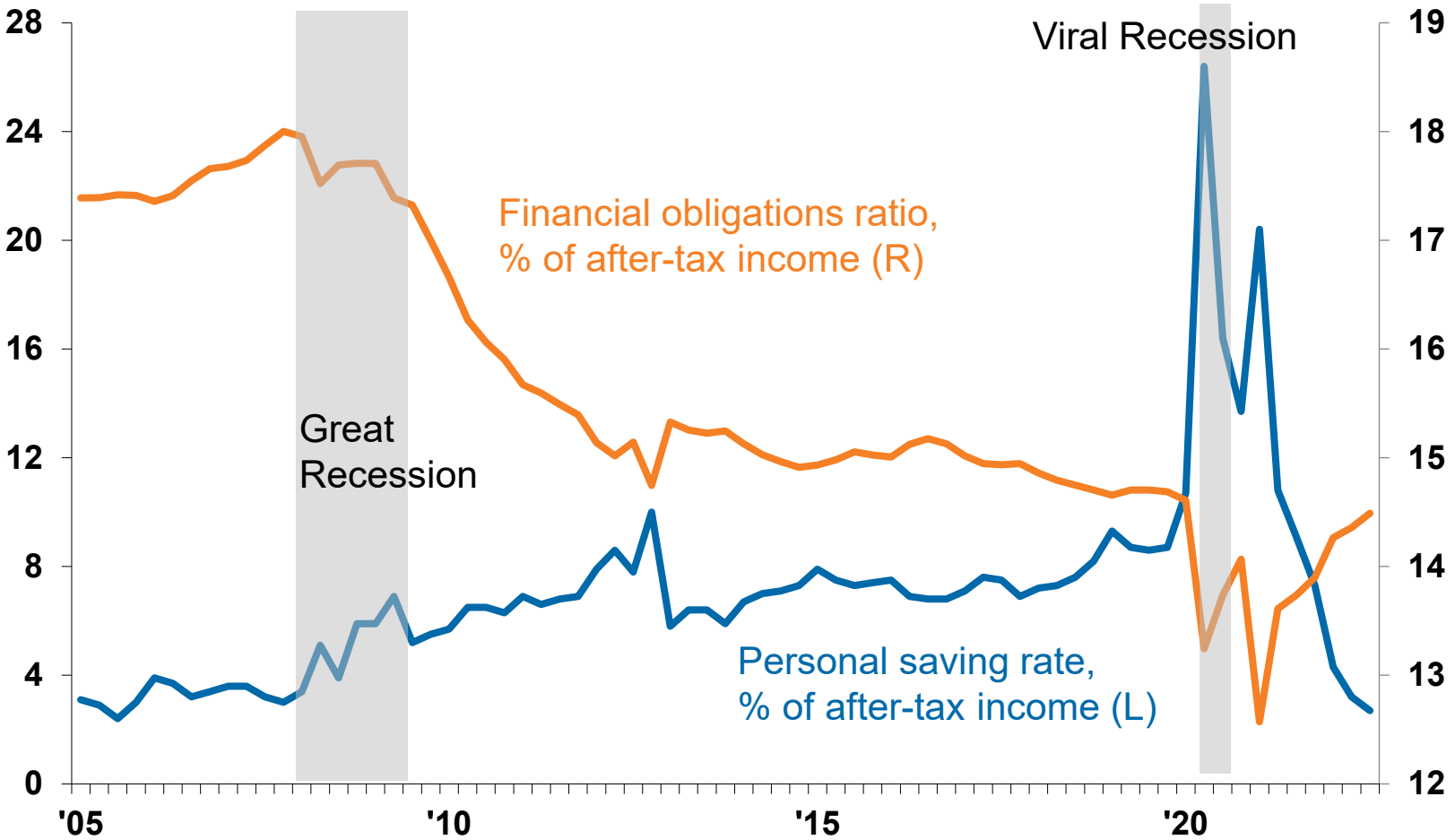


Yield spread, percentage points



Sources: Federal Reserve Board, NBER

# Accumulated Savings and Great Balance Sheets Will Limit Hit to Consumer Spending

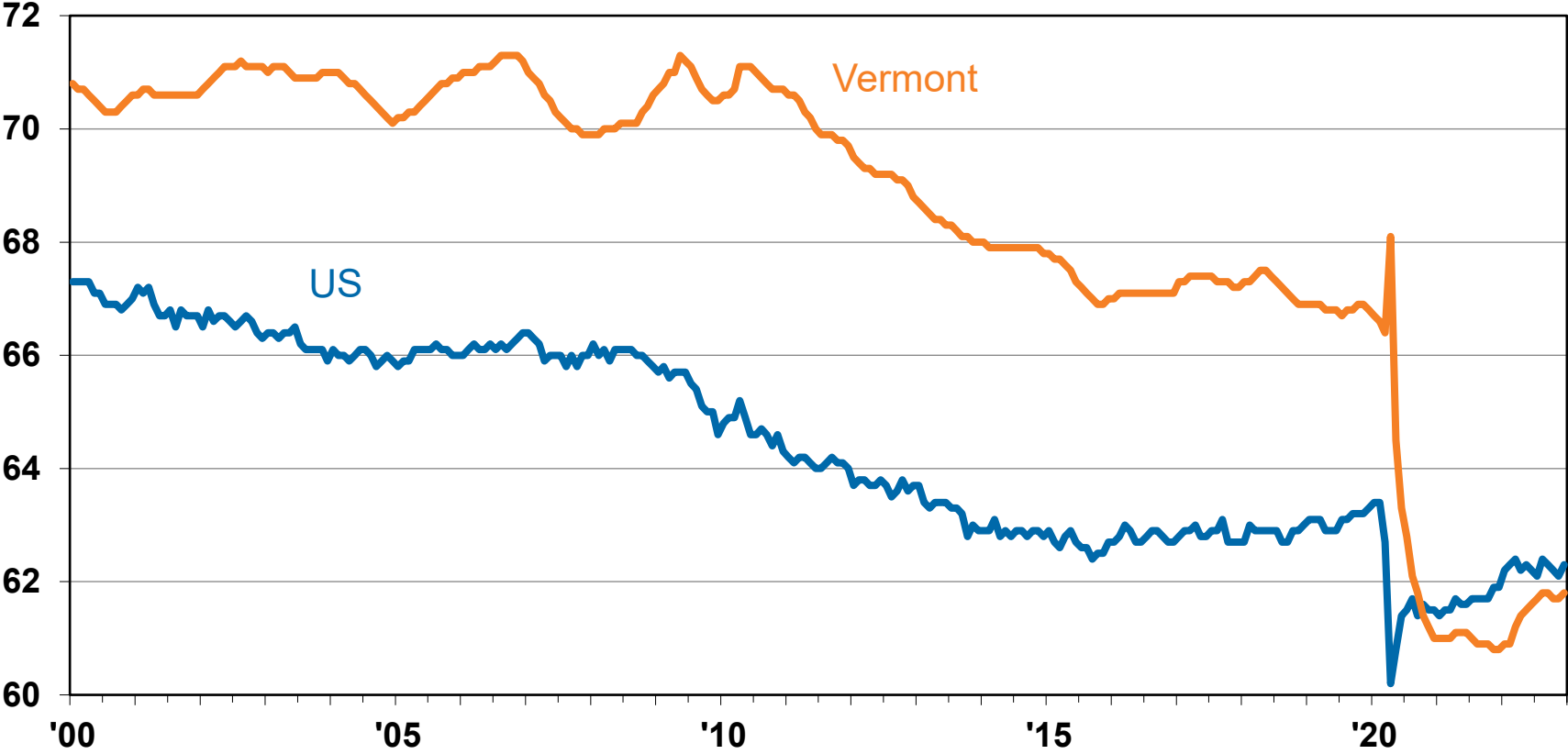


Sources: BEA; Federal Reserve Board

# Structurally Tighter Labor Market Will Limit Layoffs, Especially in Vermont



Labor force participation rate, %



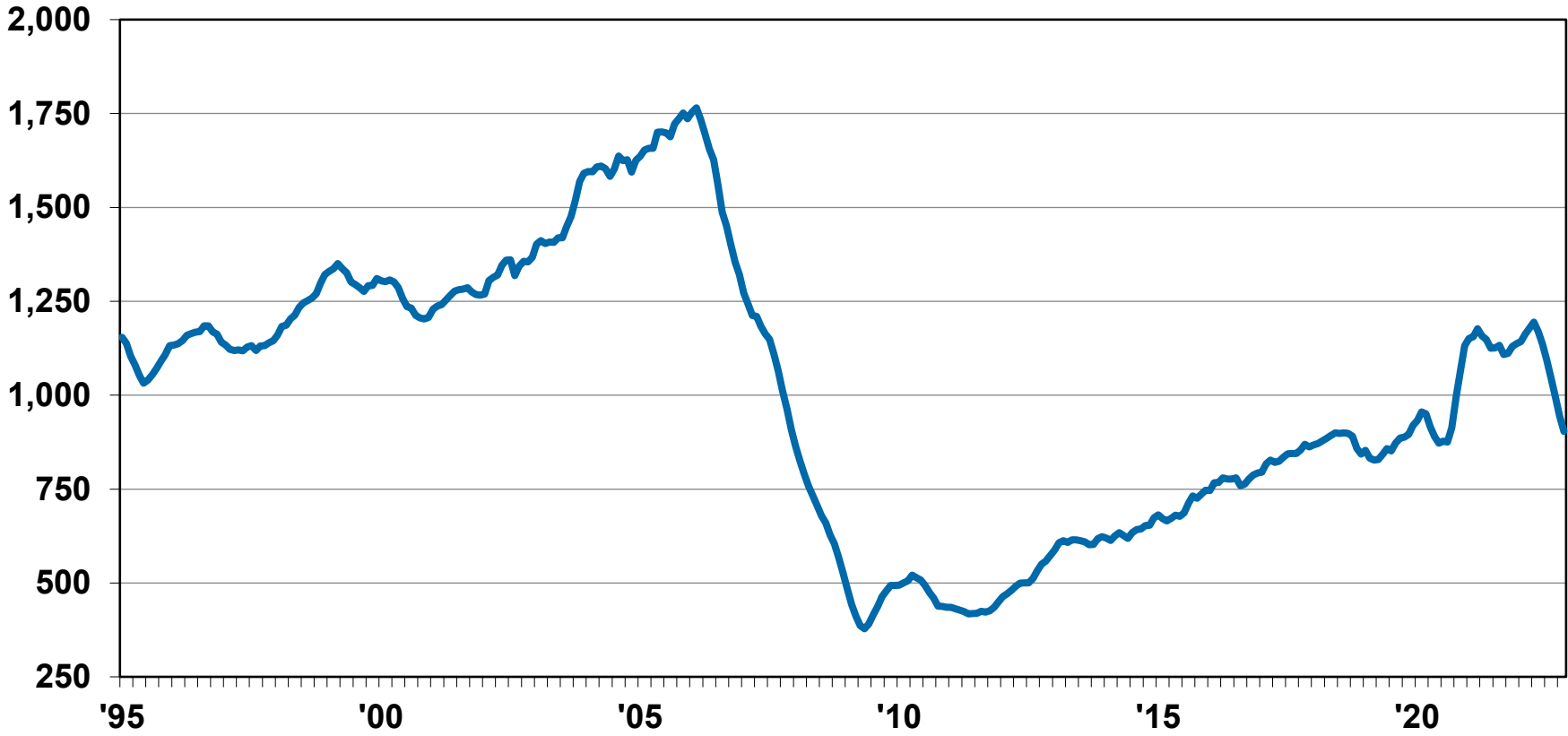
Source: BLS



# The Housing Market Has Been Undersupplied for Years



Single-family housing starts, seasonally-adjusted annualized rate, 6-month moving average, the

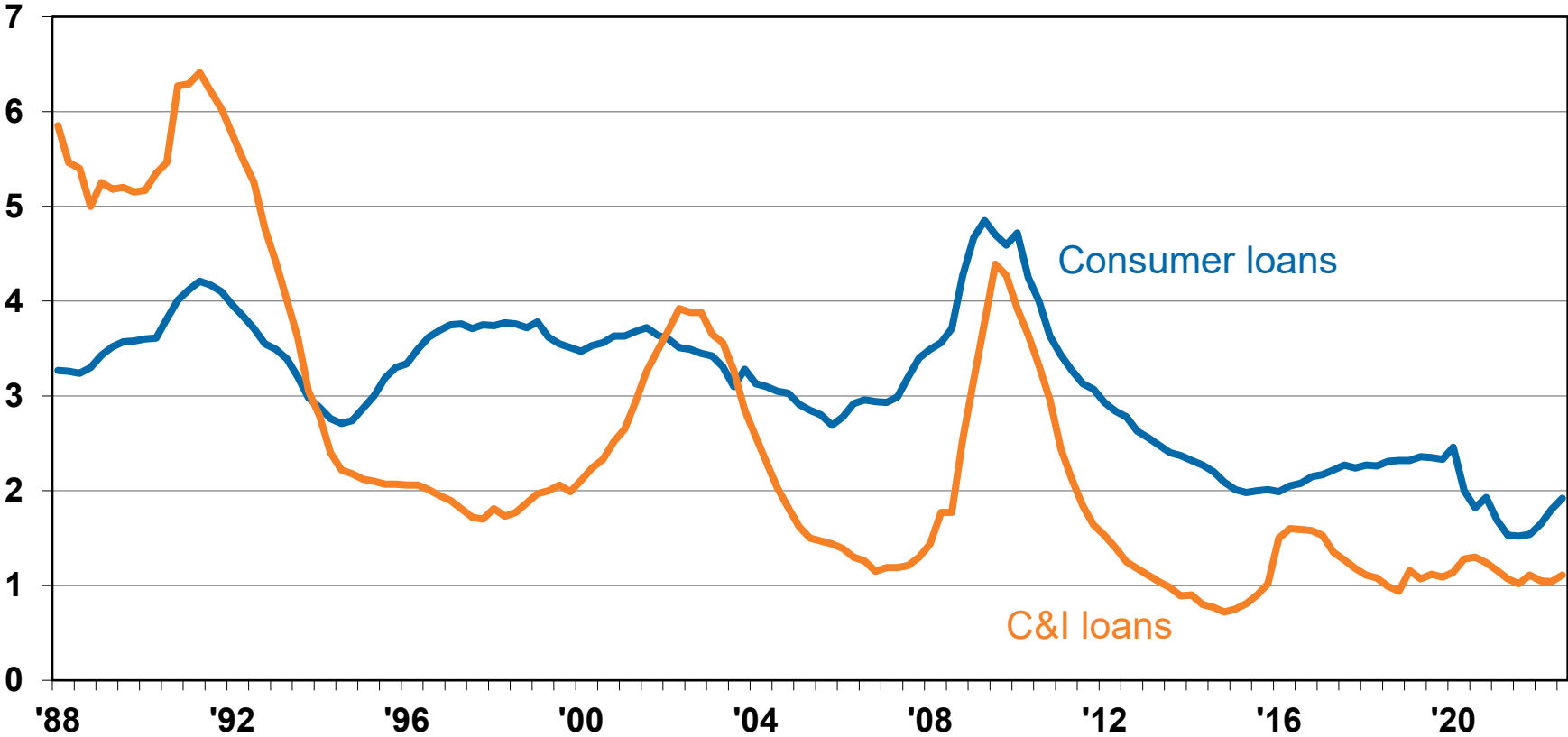


Source: Census Bureau

# Credit Quality Is in Great Shape...



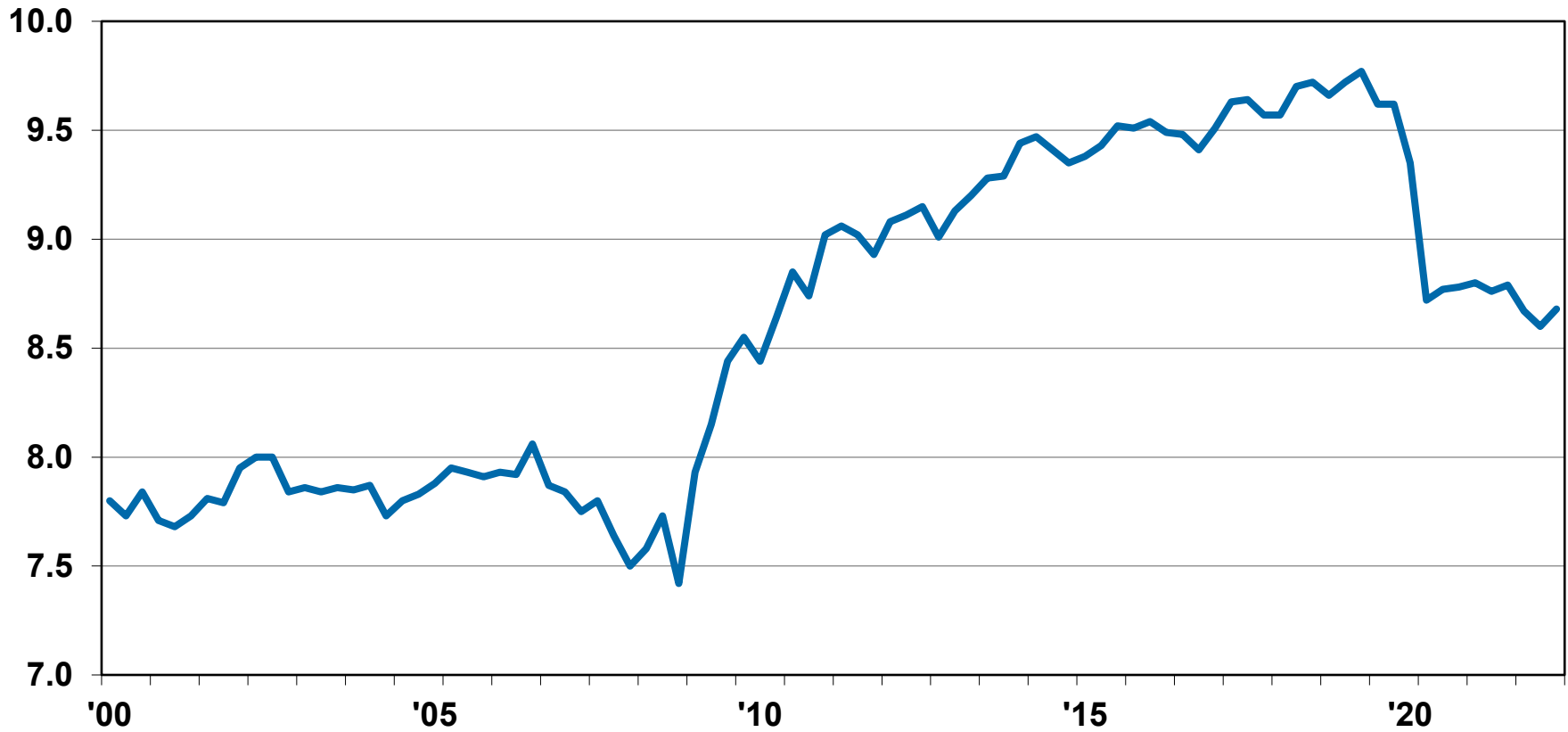
Delinquency rate, %



Source: Federal Reserve Board

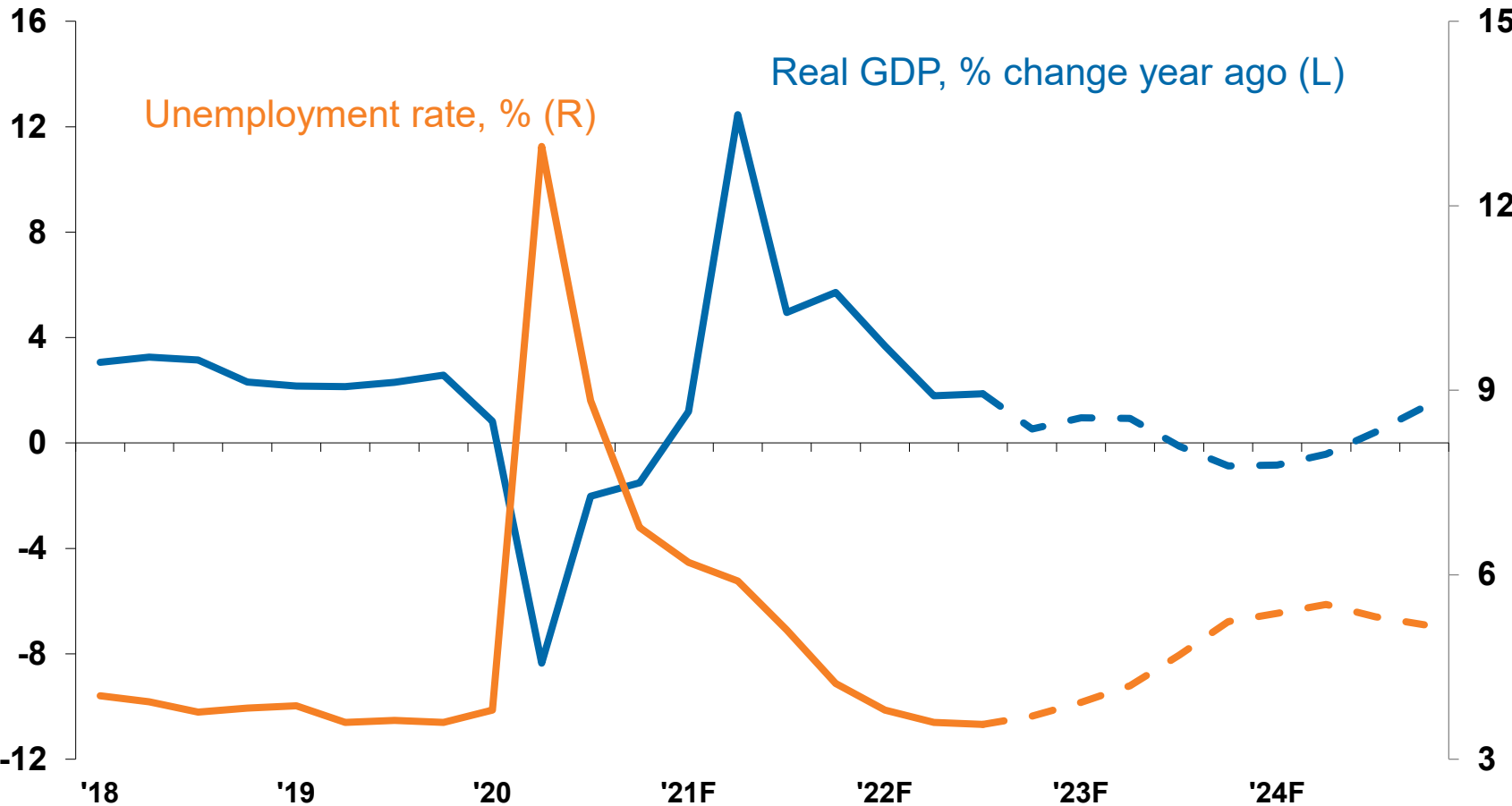
# ...And Banks Are Well Capitalized

Commercial banks, core capital ratio, %



Source: FDIC

# Most Likely Outcome Is Mild Recession in 2023

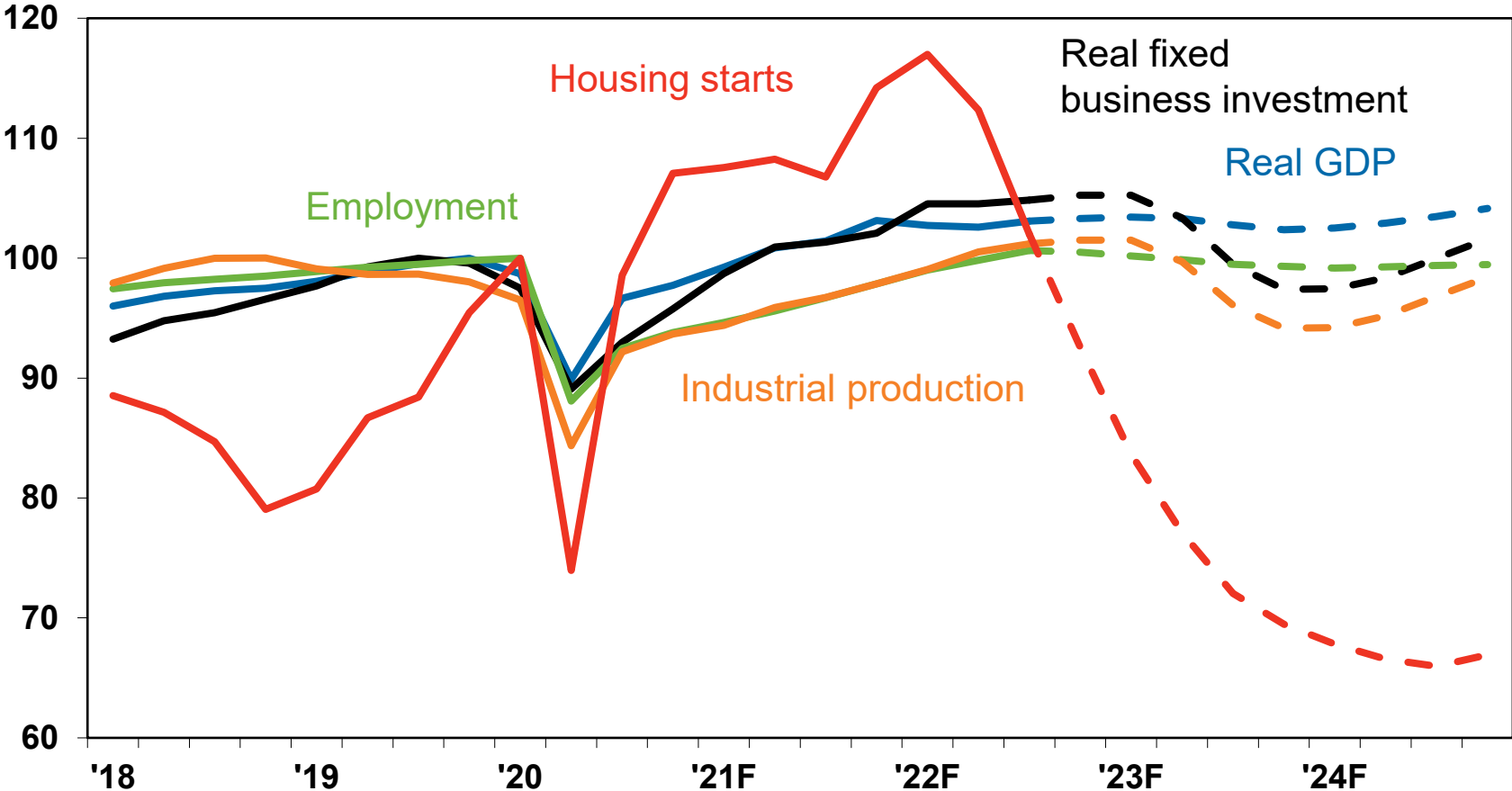


Sources: BEA, BLS, PNC

# Housing, Business Investment Will Lead the Recession



Index, pre-recession peak=100

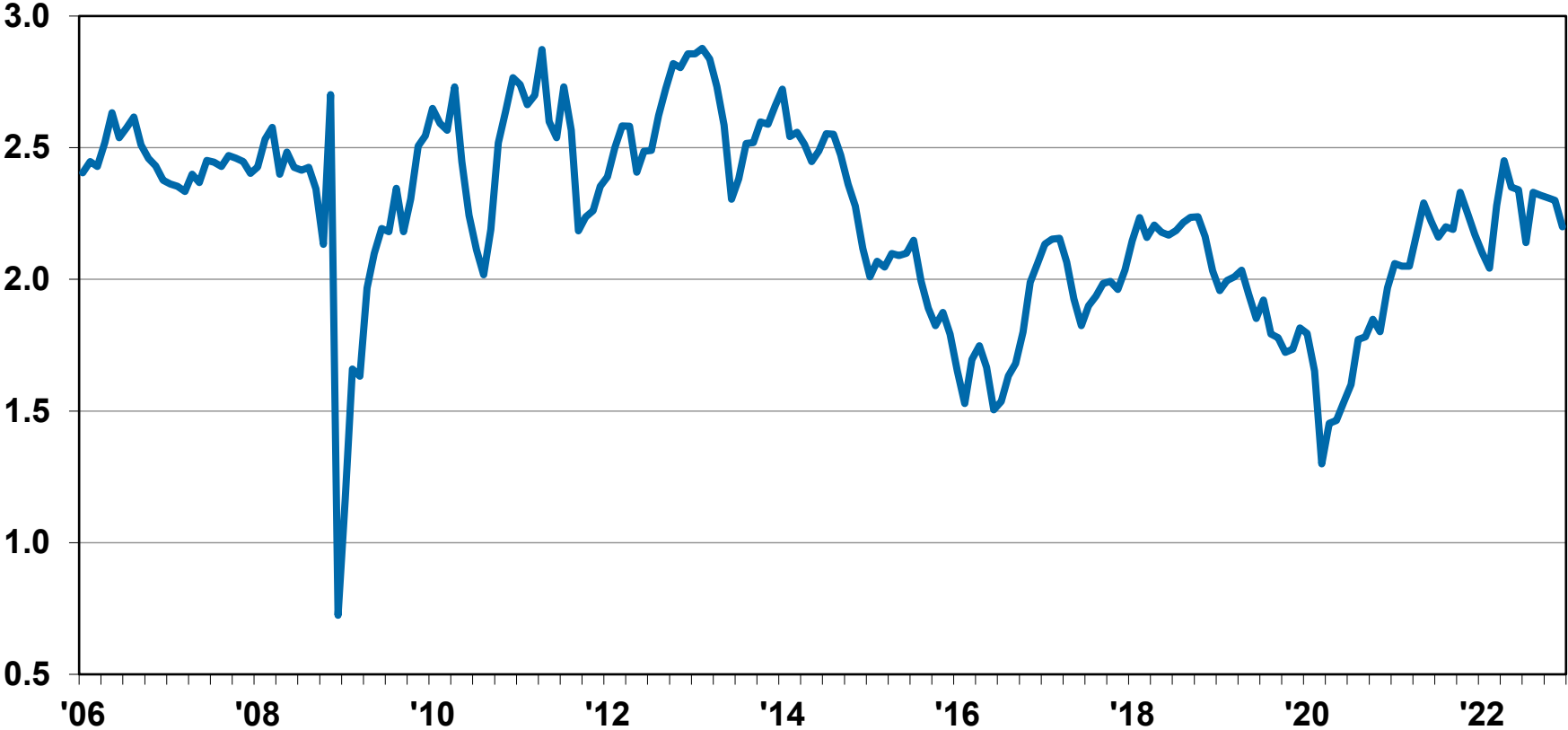


Sources: BEA; BLS; Federal Reserve Board; Census Bureau; PNC

# Inflation Will Settle Down



5-year, 5-year forward inflation expectations, %



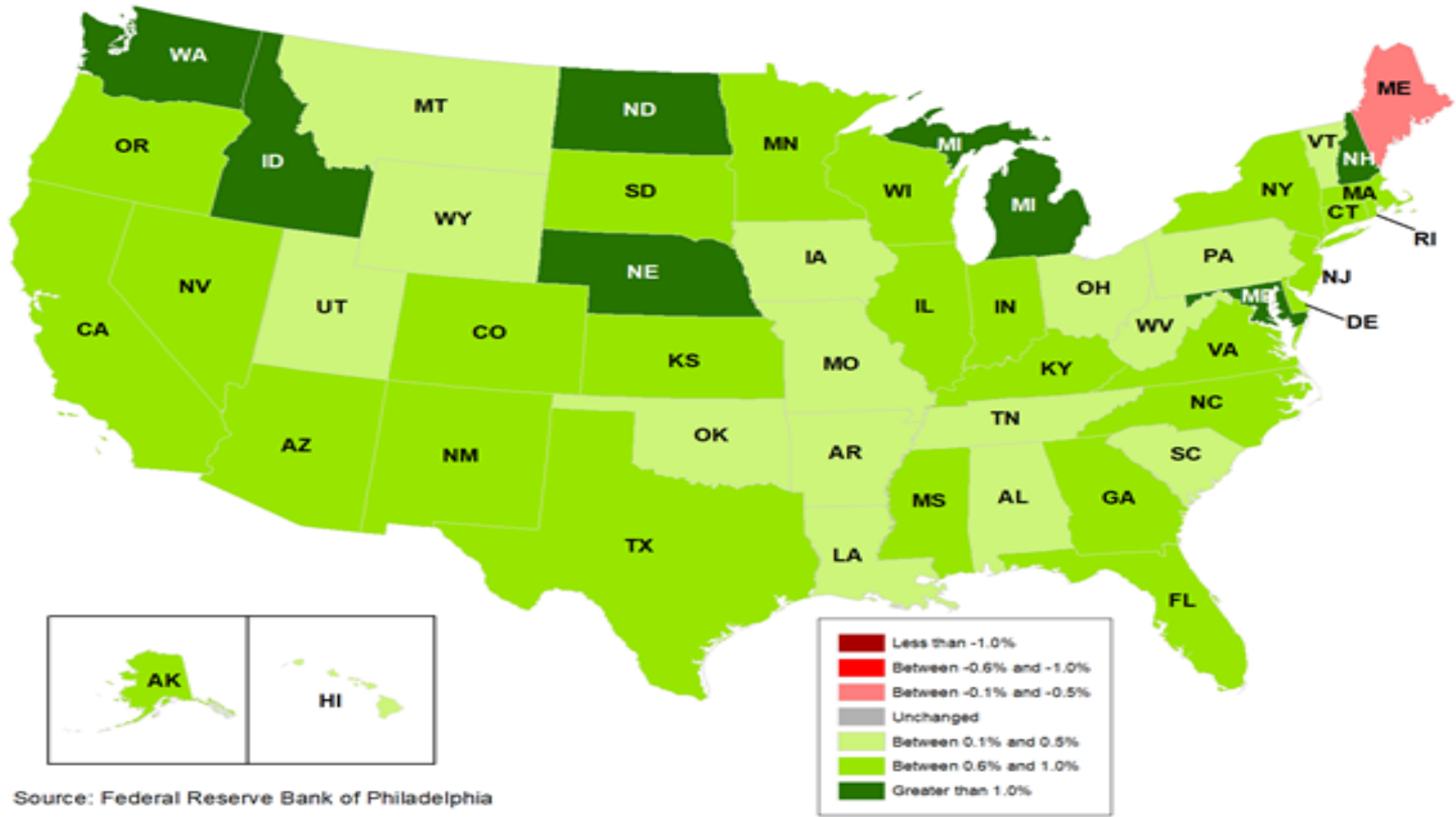
Source: Federal Reserve Board

- Very steep recession in 2020
- Not in recession now
- Fed will do what's necessary
- Structural shifts
  - Retail, supply chains, commercial real estate

- Recession not inevitable
- What happens with inflation
- Russia/Ukraine
- Path of pandemic
- Longer-run growth
- Housing market



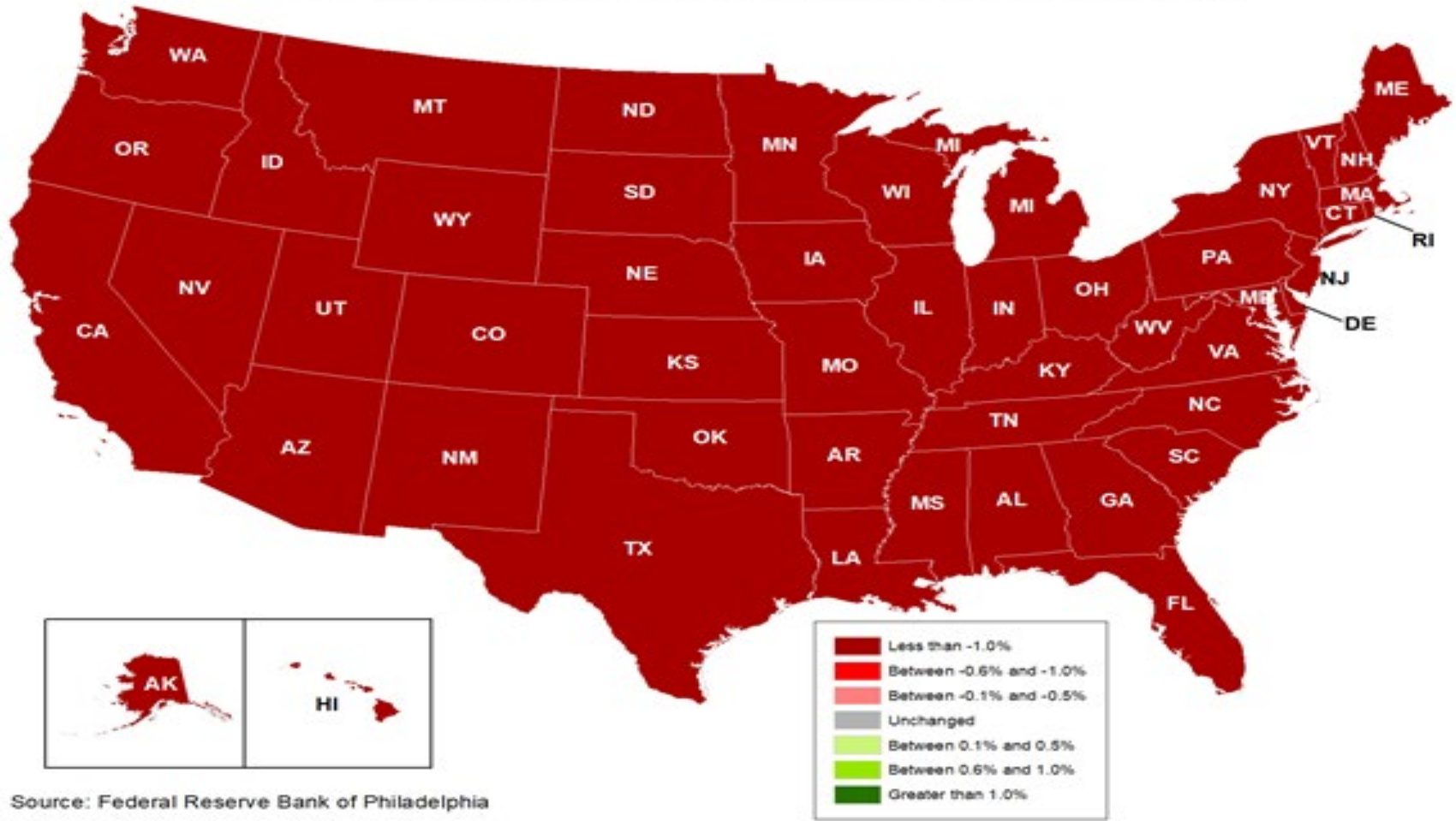
### February 2020 State Coincident Indexes: Three-Month Change



Source: Federal Reserve Bank of Philadelphia

# ...And Then Things Were Bad All Over...

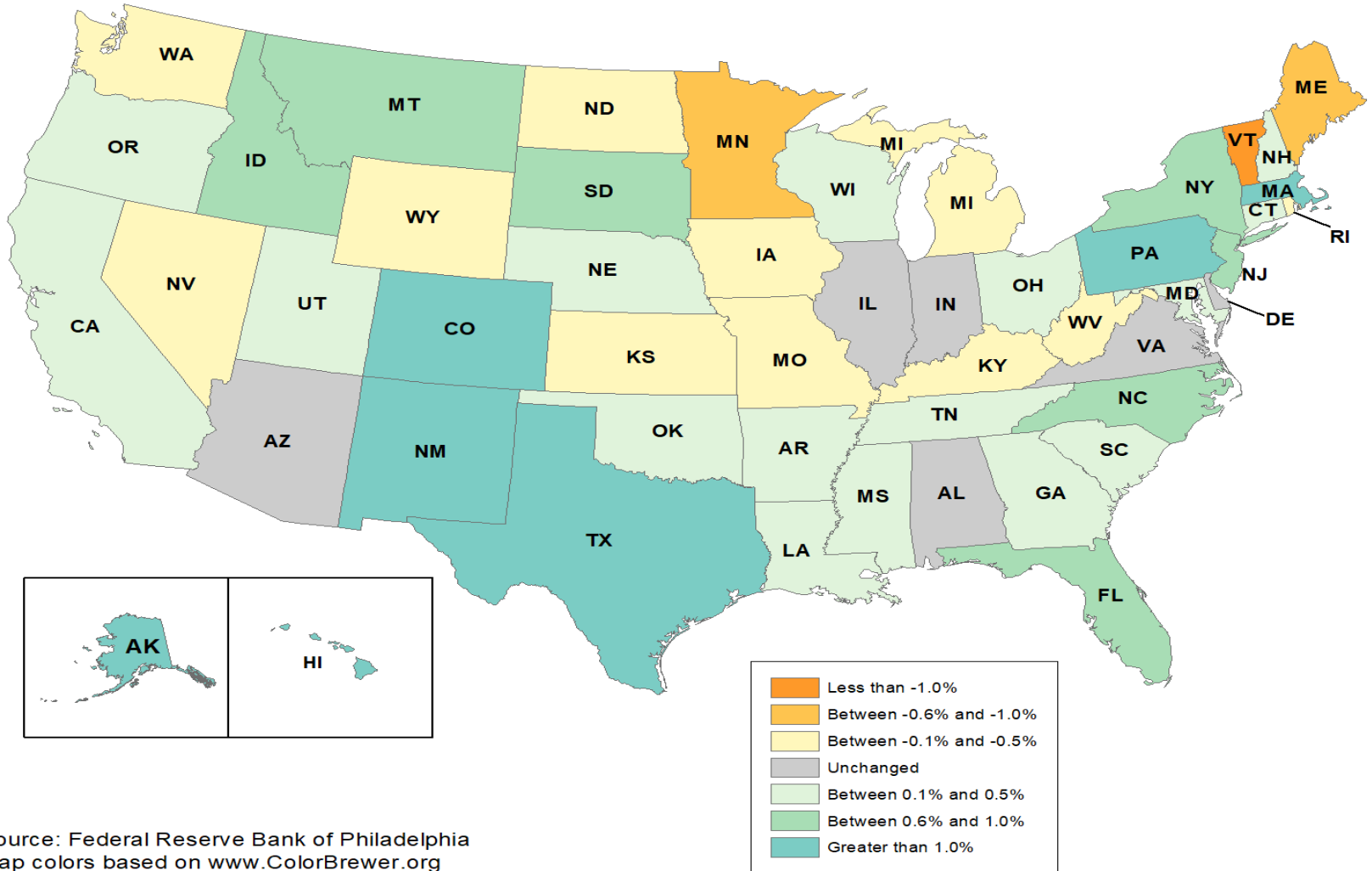
### May 2020 State Coincident Indexes: Three-Month Change



Source: Federal Reserve Bank of Philadelphia

# ...But Expansion in Most of the Country Now

## December 2022 State Coincident Indexes: Three-Month Change



Source: Federal Reserve Bank of Philadelphia  
Map colors based on [www.ColorBrewer.org](http://www.ColorBrewer.org)

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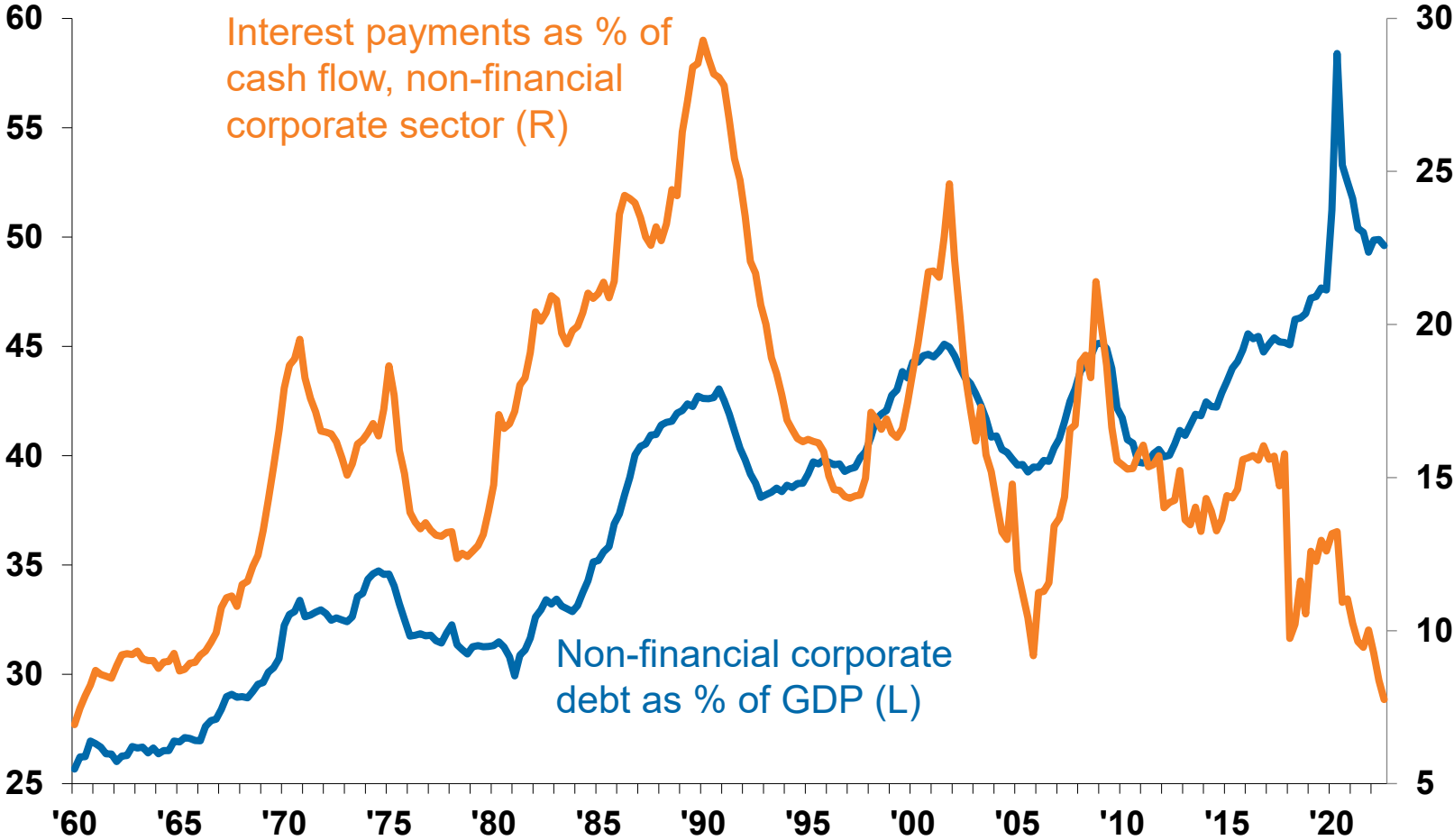
Twitter:  
**@GusFaucherPNC**

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# Business Debt Is High, But Manageable

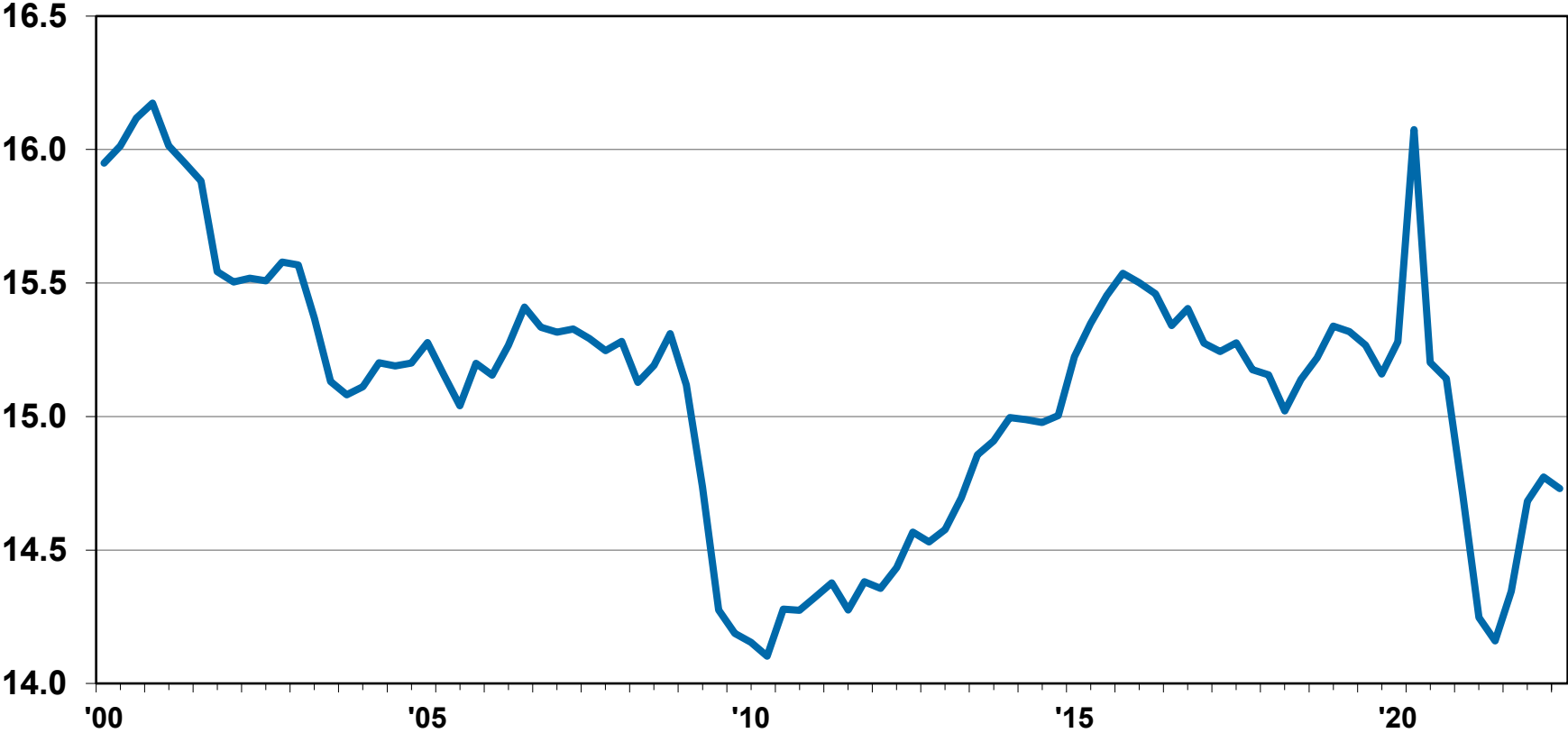


Source: BEA; Federal Reserve Board

# Low Inventories Will Support Near-Term Growth



Inventories as % of final sales of domestic product, real

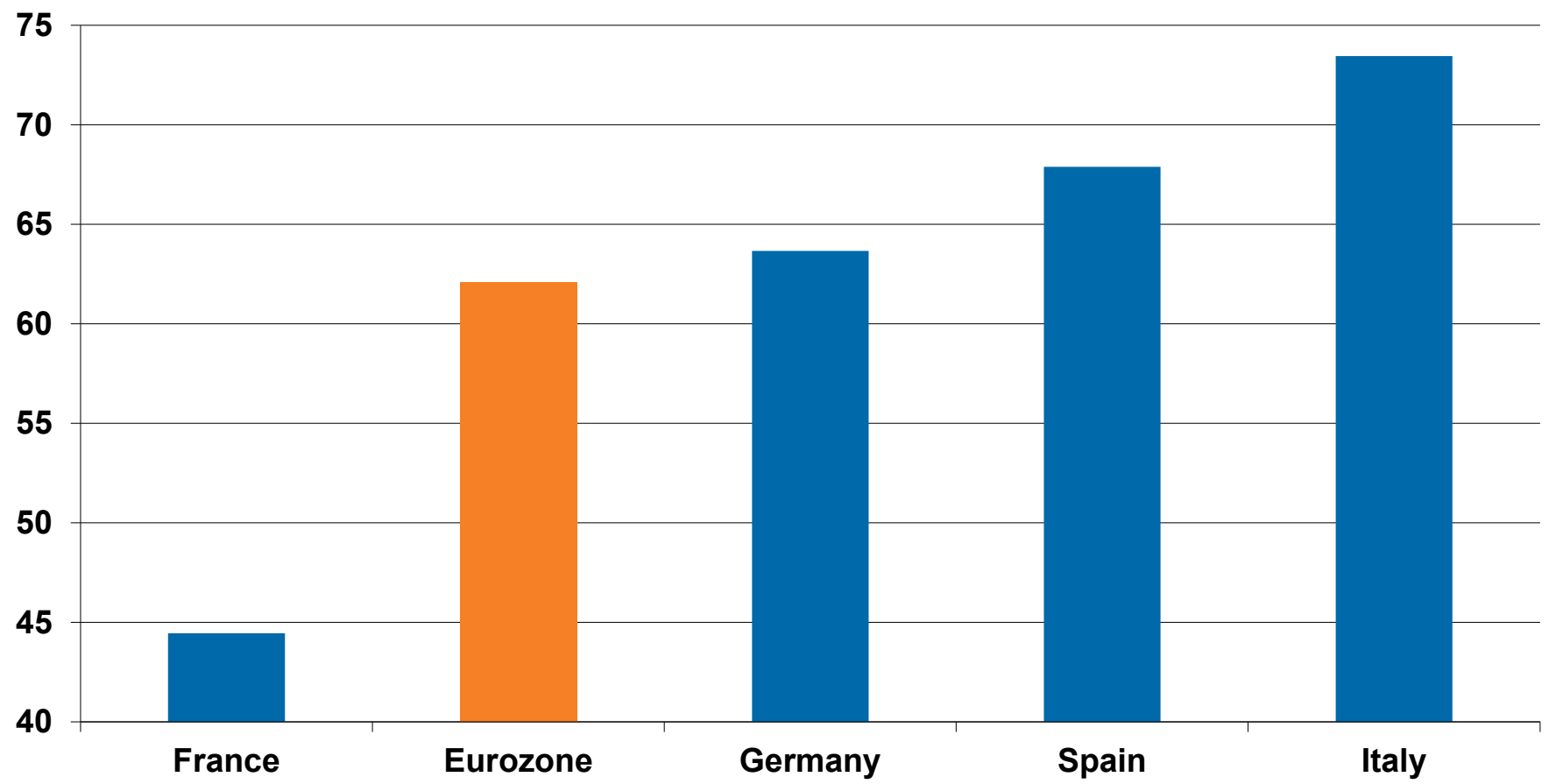


Source: BEA

# The Eurozone Is Heavily Dependent on Imported Energy...



Energy imports dependency, %



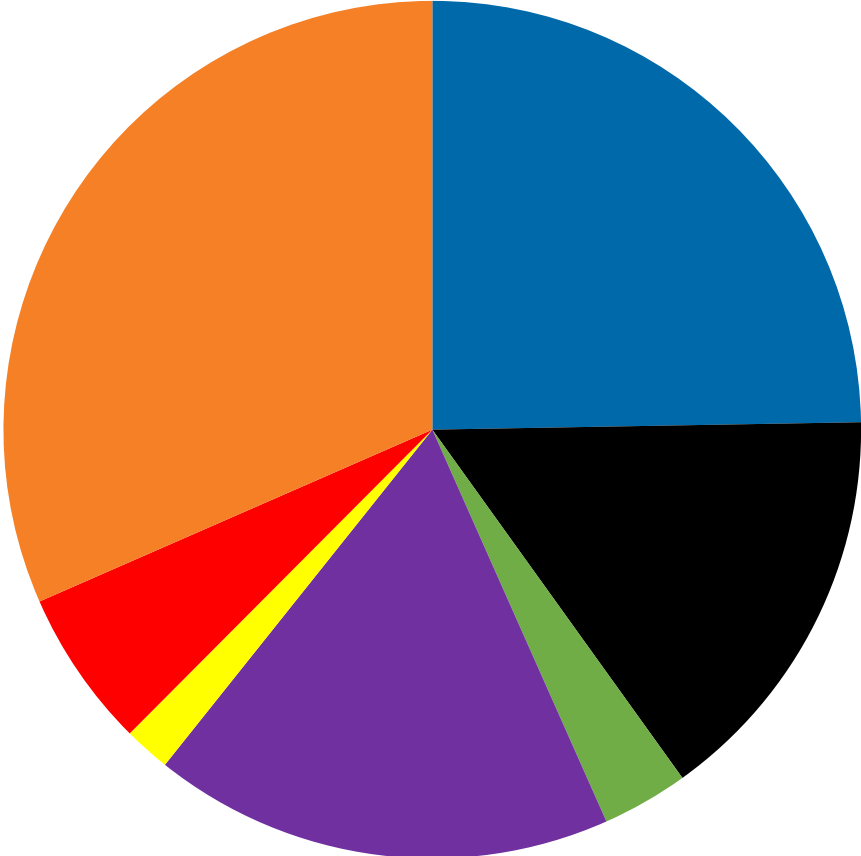
Source: Eurostat



# ...And Is a Big Part of the Global Economy

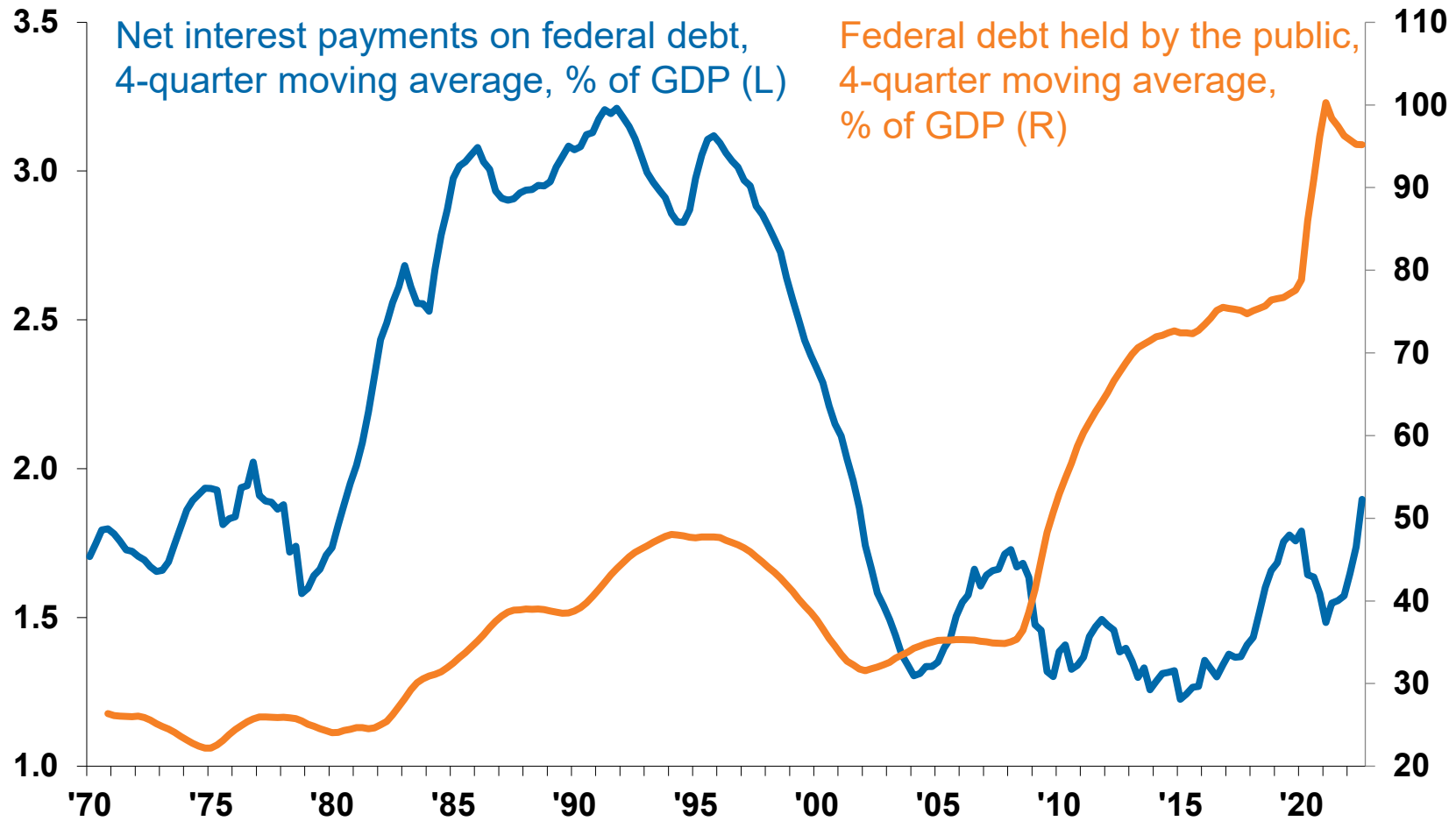
Share of global GDP, 2020

- United States (24.7%)
- Euro Area (15.4%)
- UK (3.3%)
- China (17.4%)
- Russia (1.8%)
- Japan (6.0%)
- Rest of World (37.5%)



Source: World Bank

# Two Ways of Thinking About Federal Debt; One Is a Lot More Sanguine Than the Other



Sources: Treasury Department, BEA