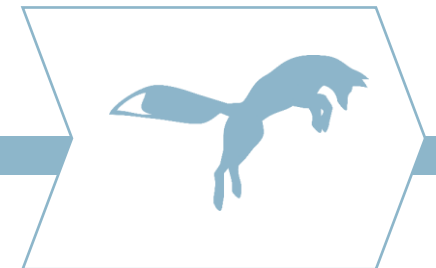


U.S. Economic Outlook

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BRIGHT FOX ANALYTICS

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Pre-Conference
Indianapolis, Indiana
August 13, 2023



Presentation Overview

- Economic outlook as it relates to state revenue sources

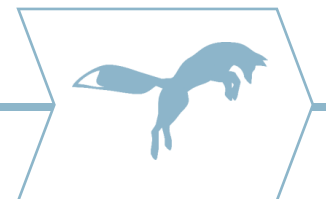
- Household income & wages
- Business income
- Consumer spending
- Housing & commercial real estate



Income, sales, and property taxes

- Why do we forecast?

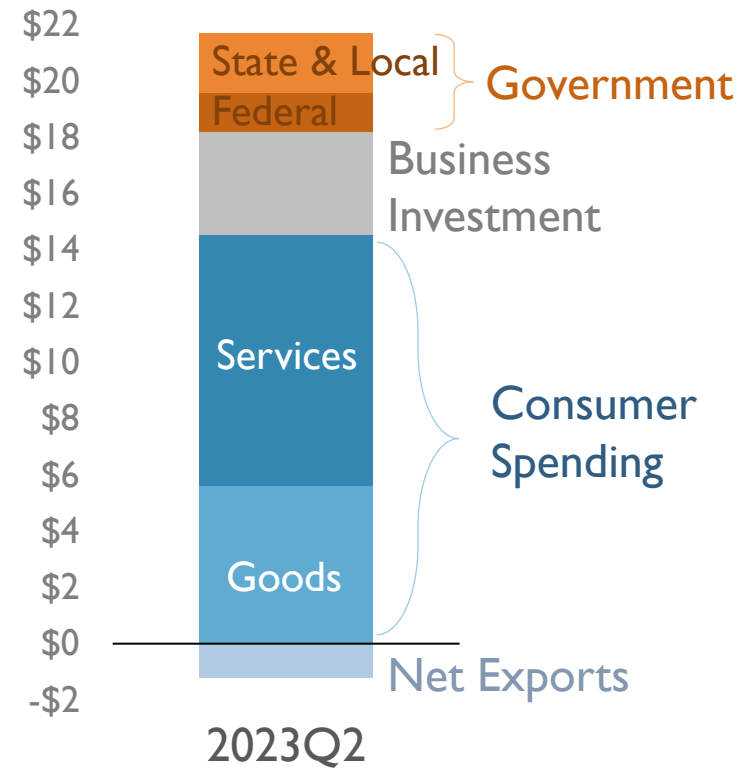
- Is there a better way to address uncertainty in state budgeting?



U.S. economic activity continues to expand despite headwinds

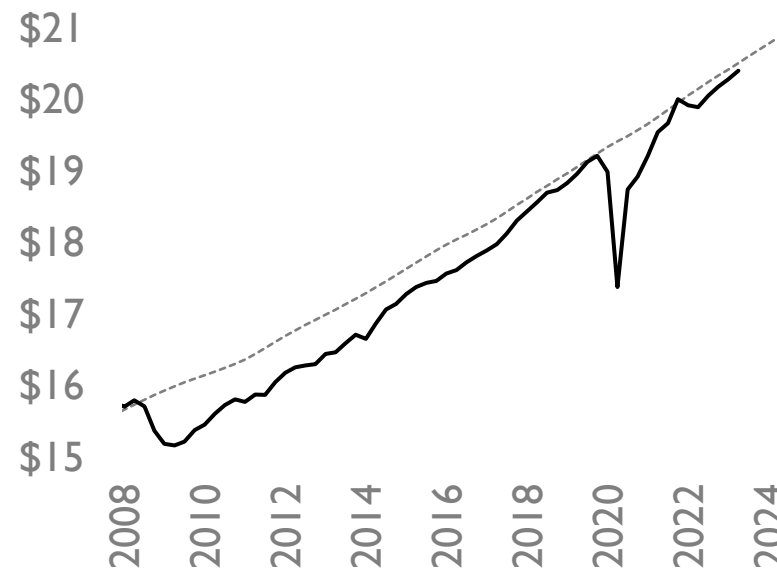
Real Gross Domestic Product (GDP)

Trillions



Real GDP

Trillions



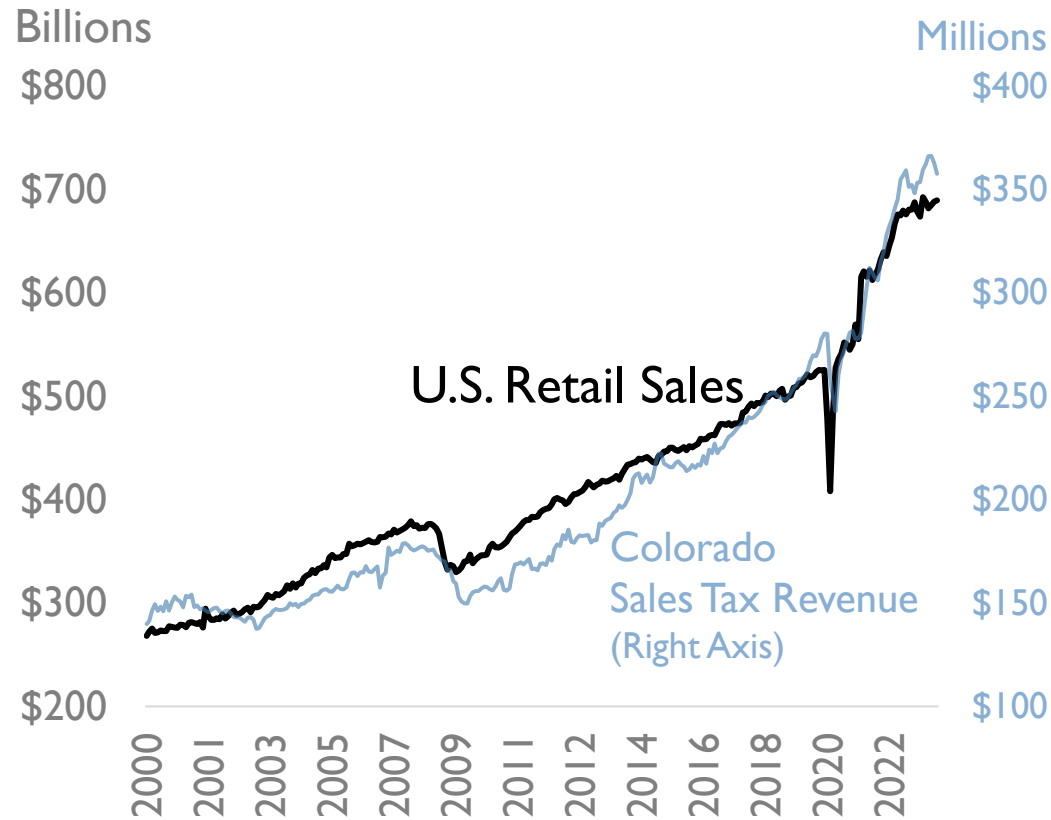
Major Components



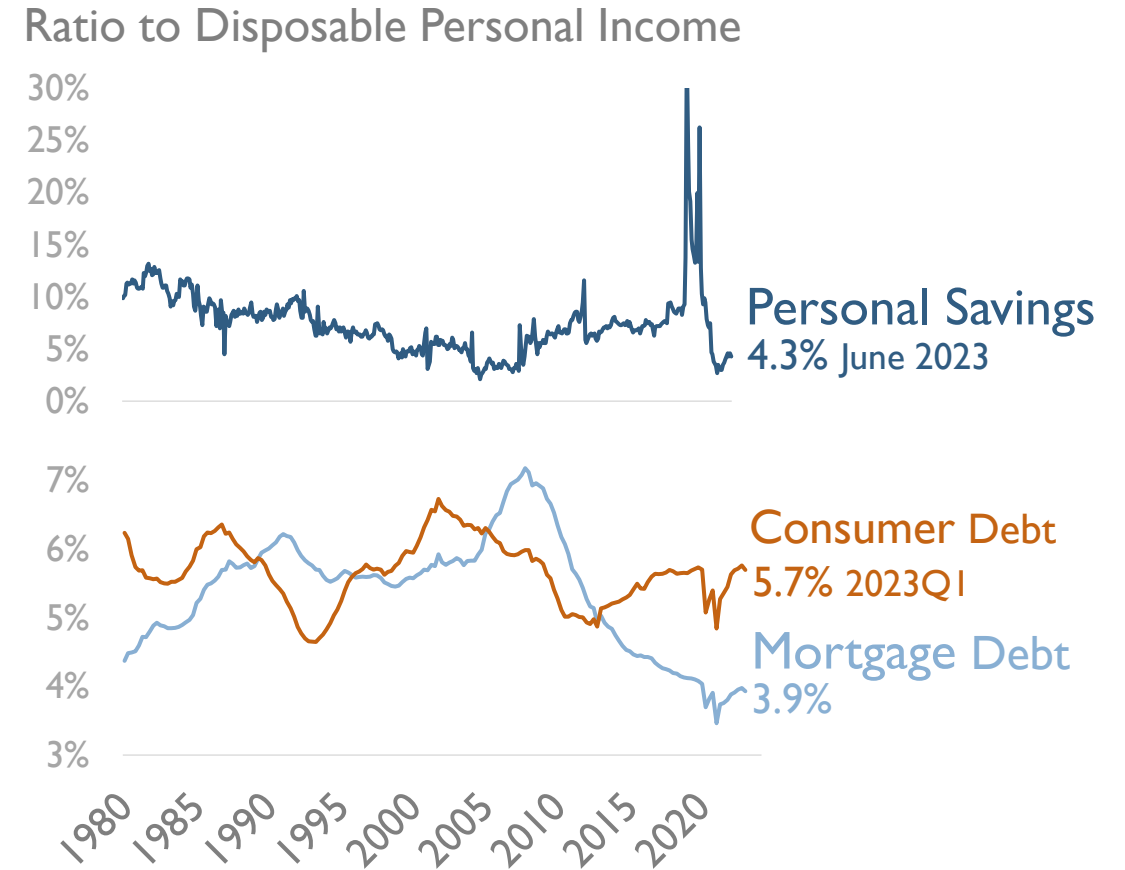
Source: U.S. Bureau of Economic Analysis (real GDP) & U.S. Congressional Budget Office (potential GDP). Data shown as seasonally adjusted annualized rates. Data shown through 2023Q2.

While consumer sentiment is down, spending remains elevated; Savings near historical lows, debt on the rise

Advanced U.S. Retail Trade & Food Services



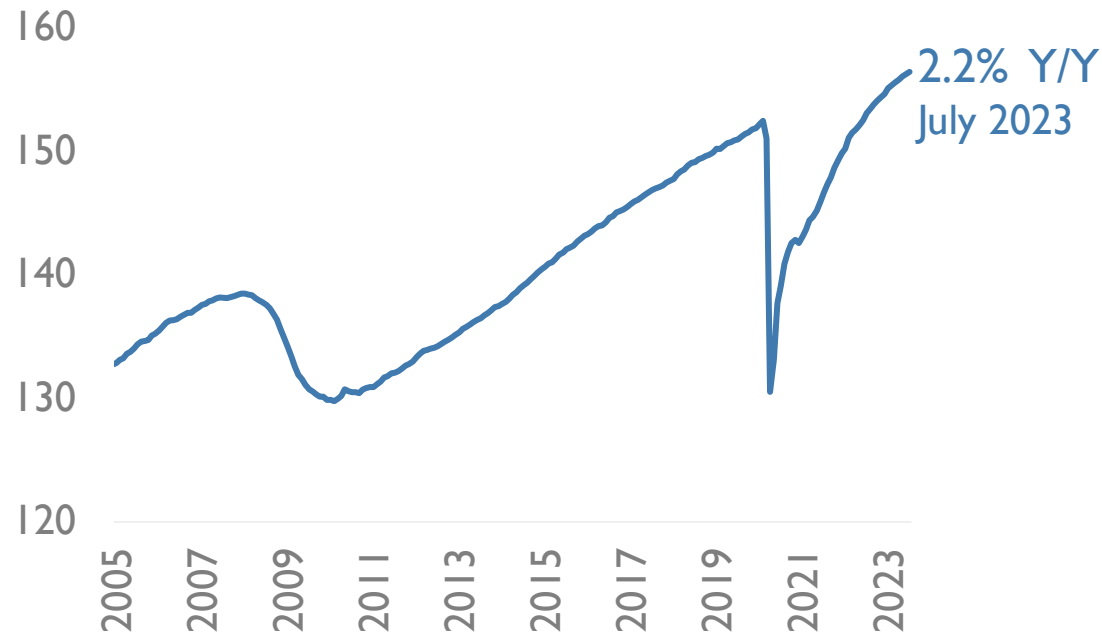
U.S. Household Balance Sheet Indicators



Labor shortages remains greatest constraint to jobs growth, wage growth has slowed but outpacing inflation

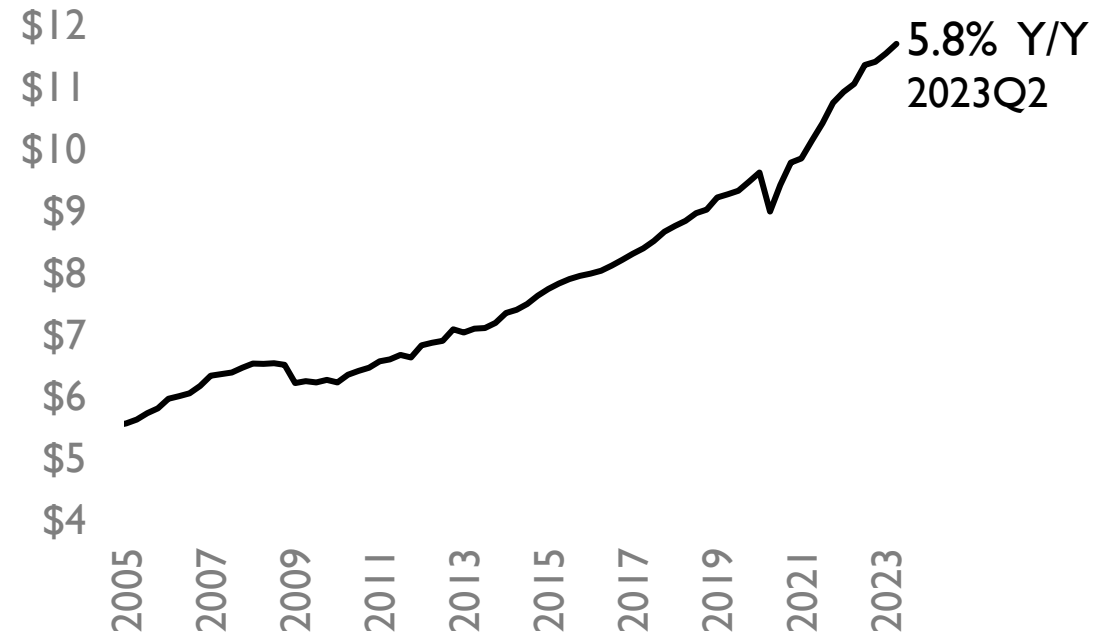
U.S. Nonfarm Employment

Millions of Jobs



U.S. Employee Compensation

Trillions

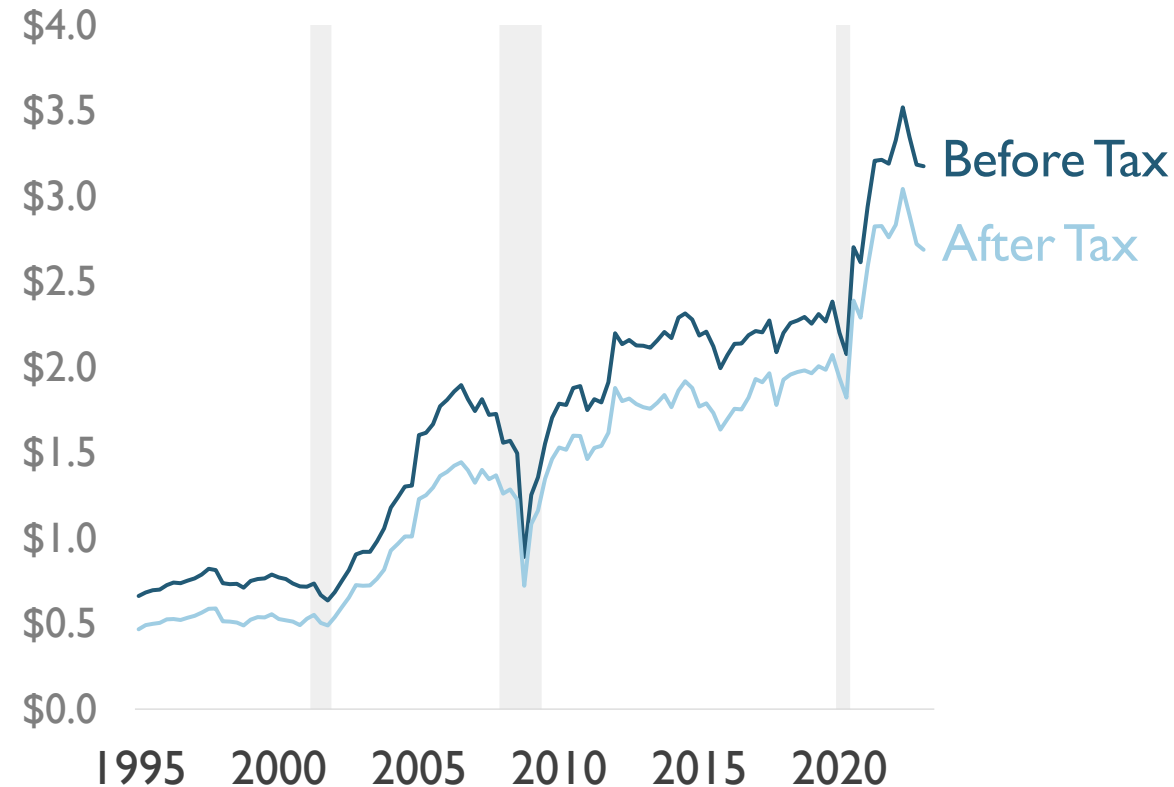


- Unemployment rate back to historical lows
- Job openings remain historically high
- Quits have slowed, remain elevated

What's next for corporate income taxes?

U.S. Corporate Profits

Trillions



Tailwinds

- Price hikes have bolstered profits
- Input prices have eased
- Consumer spending remains elevated

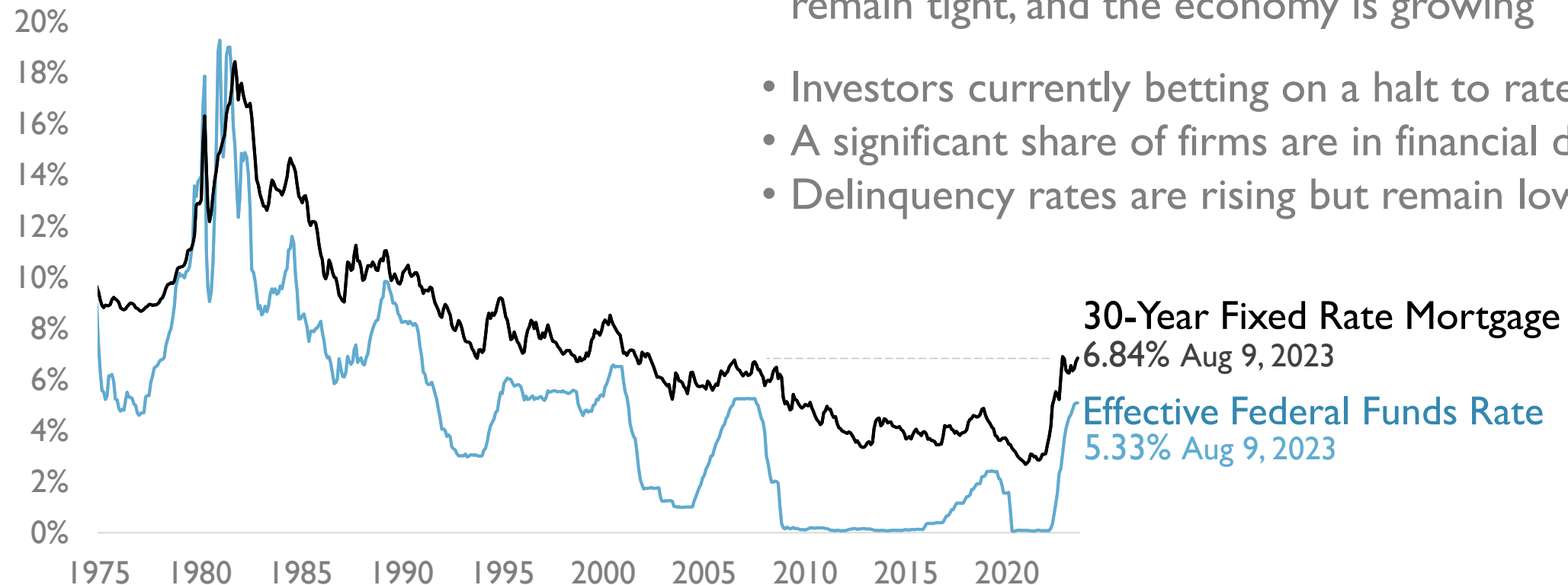
Headwinds

- Tight labor markets add to wage pressure
- Higher interest rates stem investment
- Slowing consumer spending

Source: U.S. Bureau of Economic Analysis. Seasonally adjusted annual rates.
Corporate profit amounts are without inventory valuation or capital consumption adjustments.

Monetary Policy

U.S. Interest Rates



- With rapid interest rate hikes, inflation and the housing market has cooled. Yet, labor markets remain tight, and the economy is growing
- Investors currently betting on a halt to rate hikes
- A significant share of firms are in financial distress*
- Delinquency rates are rising but remain low

Source: Federal Reserve Board of Governors & Freddie Mac. Average monthly rates.

*Federal Reserve Board of Governors FEDS Notes (Ander Perez-Orive and Yannick Timmer 2023). Available [here](#).

Why aren't consumers & businesses more responsive to rate hikes? Information flows aren't what they used to be.

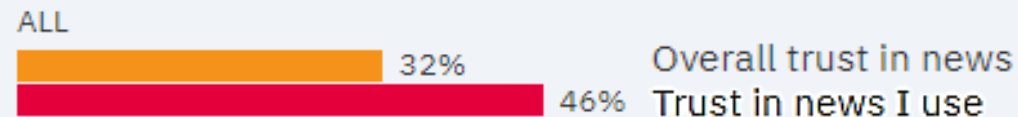
- Many aren't watching the news

% Sometimes or often avoid news



- Lack of trust

% trusting news



- The economic story isn't consistent

THE WALL STREET JOURNAL.

CFO JOURNAL

CFOs Are More Optimistic on Side-Stepping a Recession

Costs remain a concern, but a strong labor market and moderating inflation have assuaged finance chiefs' worst economic fears

By [Jennifer Williams-Alvarez](#) [Follow](#) and [Mark Maurer](#) [Follow](#)

Aug. 11, 2023 5:30 am ET

MARKETS INSIDER

Investors are 'sleepwalking' into market turmoil and a recession early next year, top economist Steve Hanke warns

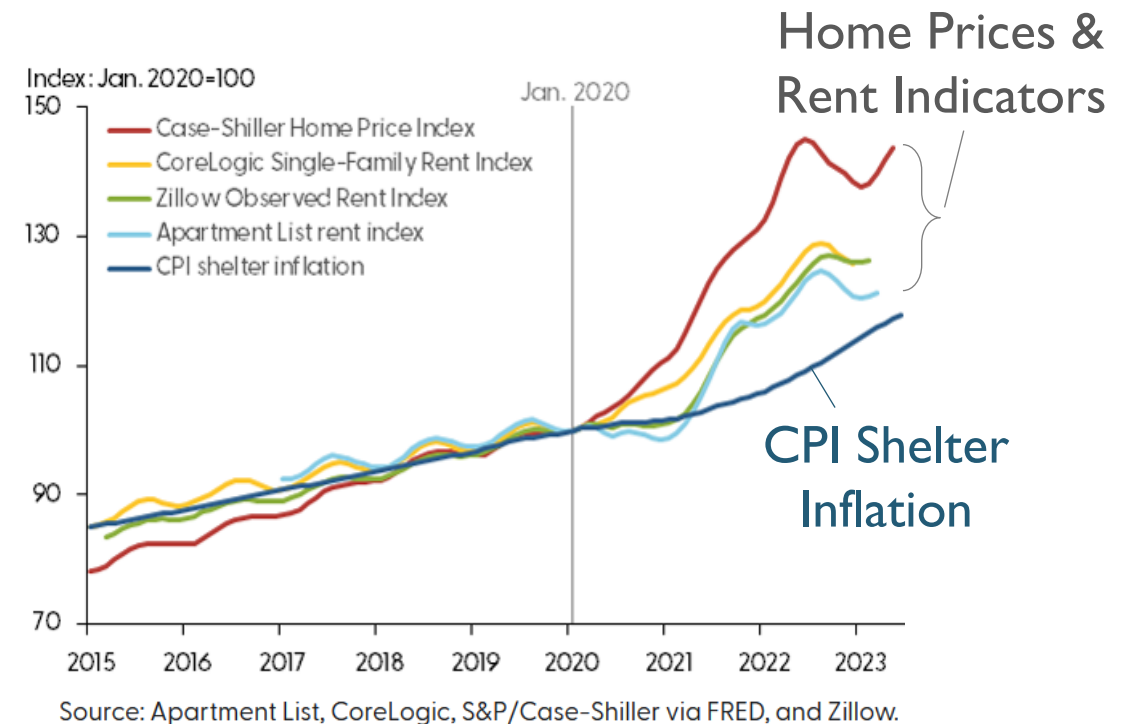
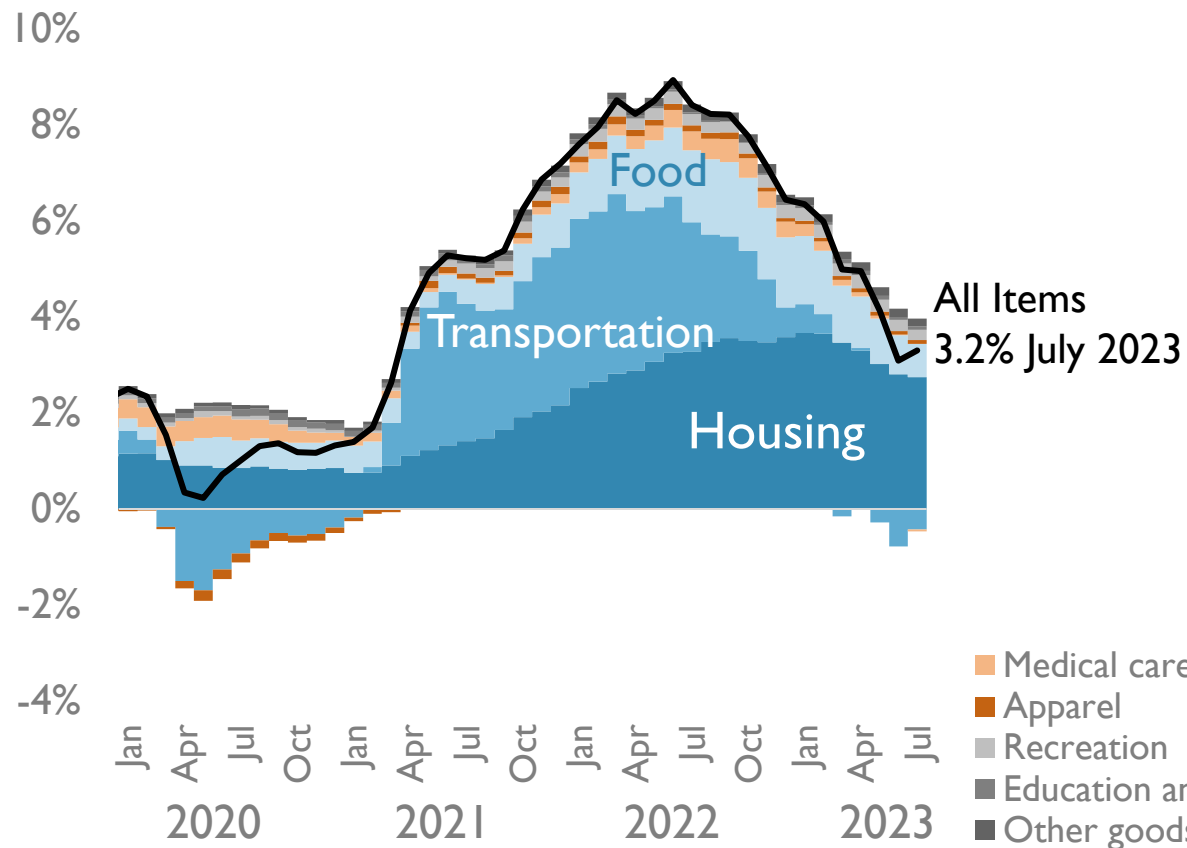
Theron Mohamed Aug 9, 2023, 9:16 AM MDT



Inflation has moderated and is expected to cool further along with the housing component

CPI Inflation, All U.S. Urban Areas

Contribution to Percent Change by Component



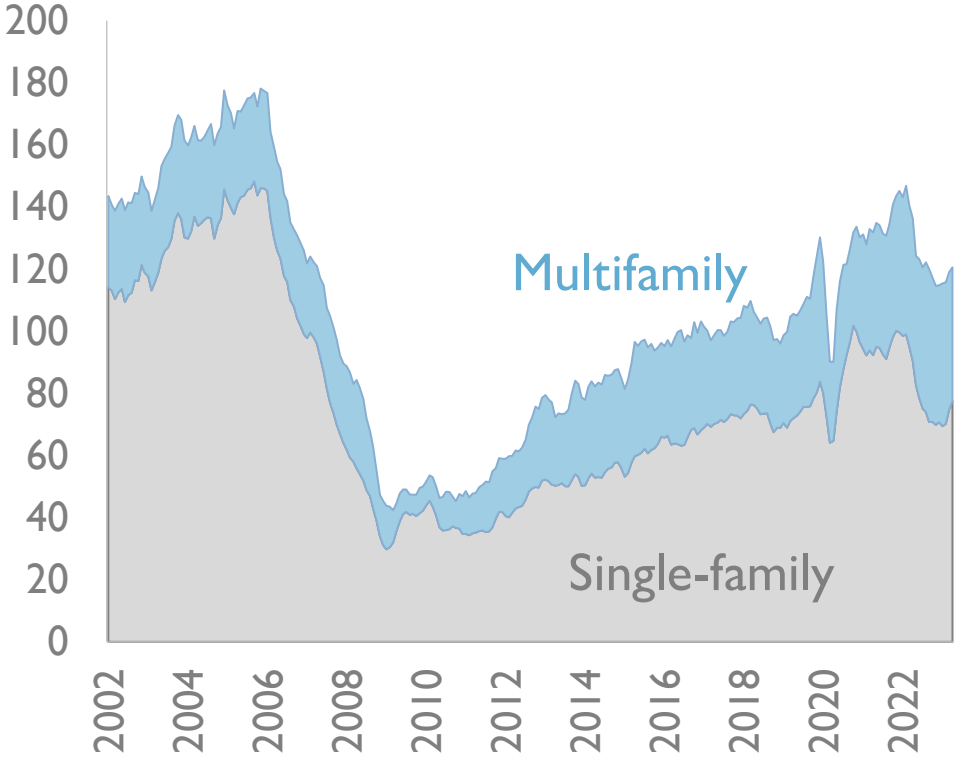
Source: Bureau of Labor Statistics with author's calculations using relative weights.

Housing chart from the San Francisco Fed: <https://www.frbsf.org/economic-research/publications/economic-letter/2023/august/where-is-shelter-inflation-headed/>

New construction activity expected to slow on higher interest rates, labor shortages, weak demand for CRE

Permits for U.S. Housing Units

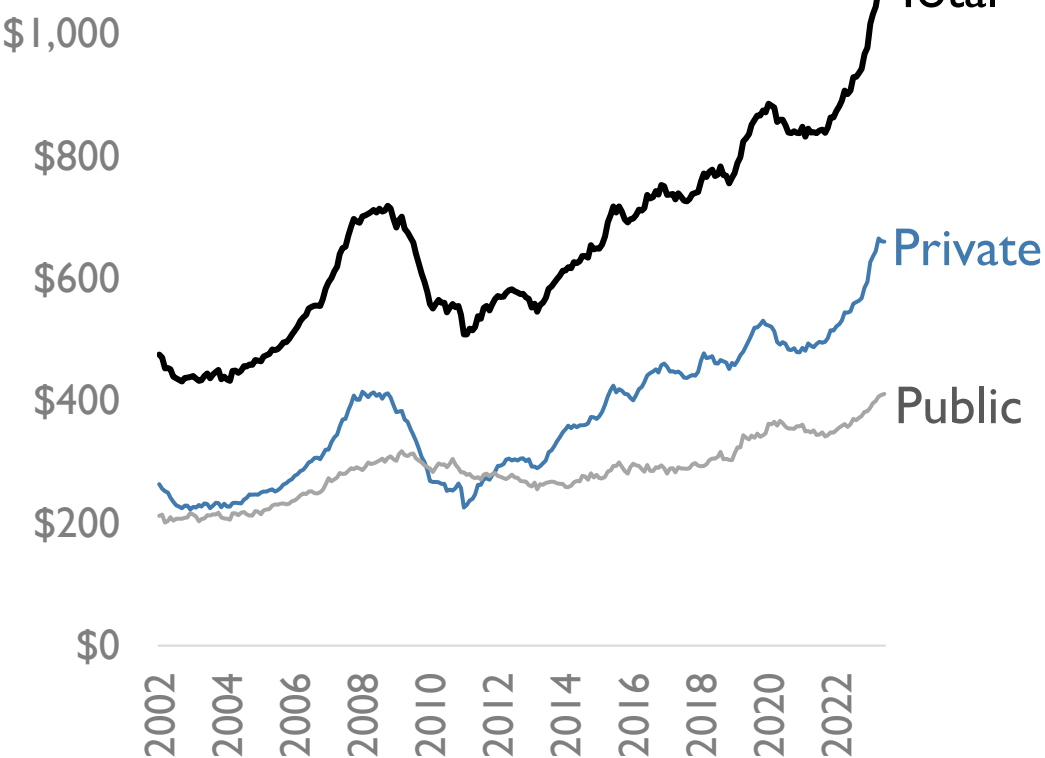
Monthly Permits Issued, 3-Month Moving Average



Source: U.S. Census Bureau and U.S. Department of Housing and Urban Development. Data are seasonally adjusted and through June 2023.

Nonresidential Construction Spending

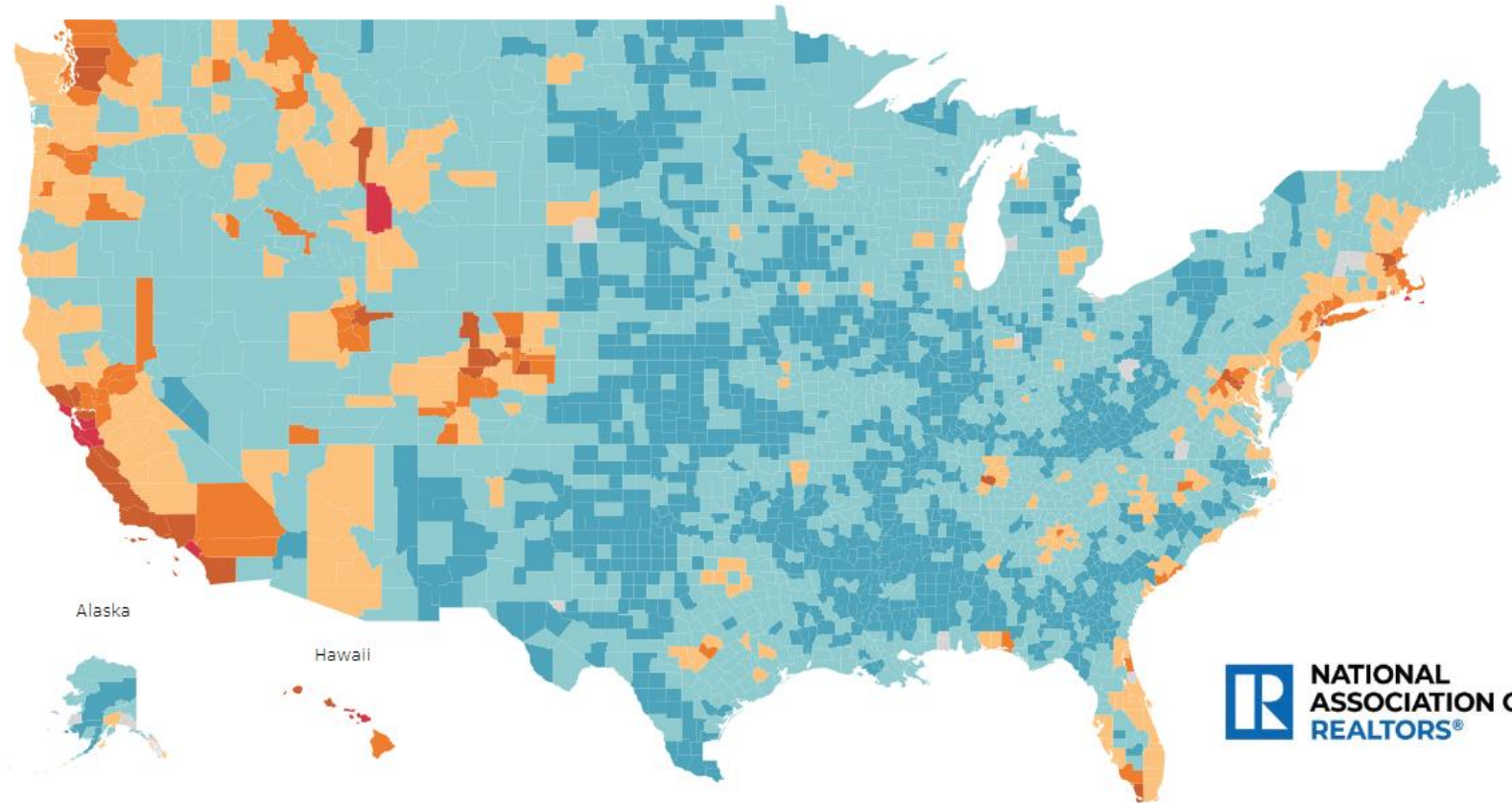
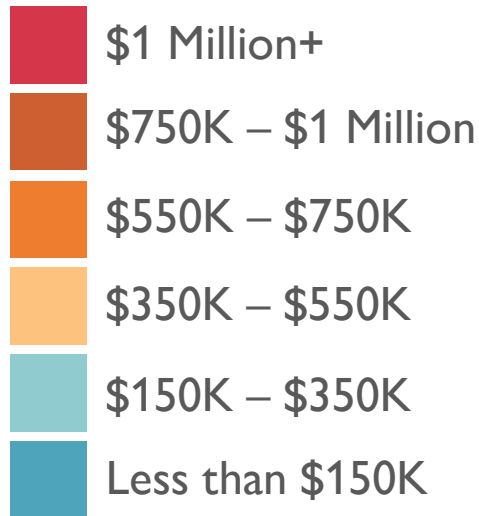
Billions



Source: U.S. Census Bureau. Data shown as seasonally adjusted annual rates and are through June 2023.

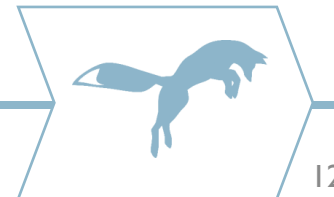
Home prices will impact inflation, migration, labor: Strongest growth expected in lower cost metros

2023Q1 Median Home Prices



Economic Outlook Summary

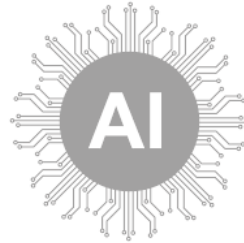
- Consumer resiliency has been remarkable, can it last?
- Labor shortages are slowing growth, maintaining pressure on wages
- Inflation cooling with housing cost stabilization, higher interest rates
- Businesses investment pinched by interest rate hikes, cracks emerging
- Lower cost metro areas will see the strongest economic growth
- Commercial real estate will remain weak in urban cores



Risks to the outlook: Known uncertainties

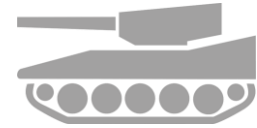
Technological Change

What does AI mean for the economy?
How will technological change impact state budgets?



Geopolitical Risk

How could war, terrorism, or cyber attacks impact states?
What will protection cost?



Climate Change

What costs, crises, or revenue impacts could weather & natural disasters create?



Monetary & Fiscal Policy Risk

What happens if the federal debt gets too big?
Can federal funding remain as big as in the past?
Where will interest rates go next?





Why do we forecast?

Current Approach to State Budgeting

Predict

The most likely future for revenue and (some) expenditures



Act

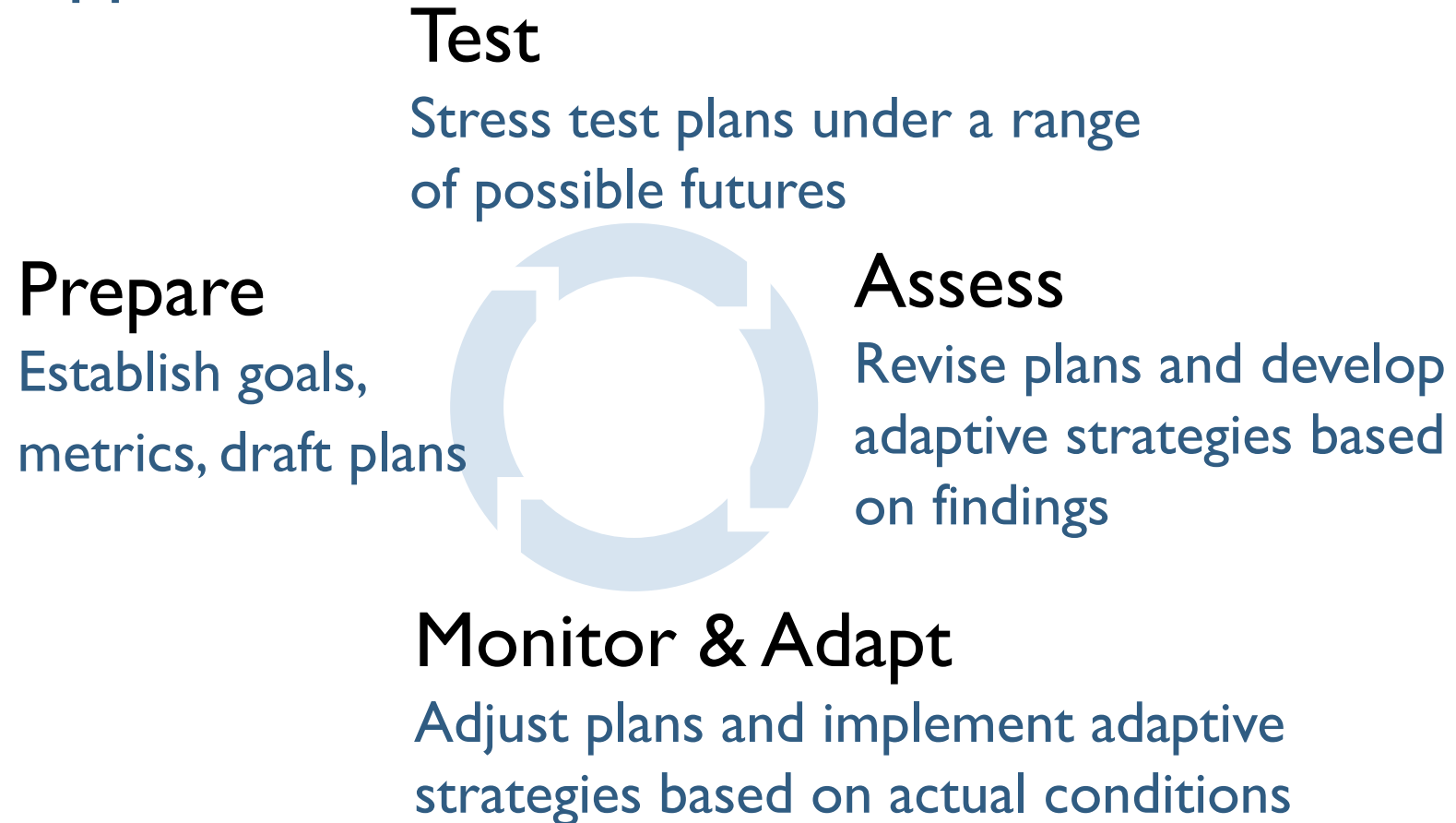
Optimize spending based on predicted amounts

Potential issues with approach

- Uncertainties may be ignored
- Reinforces near-term planning
- May promote boom-bust spending

Is there a better way to budget with uncertainty?

An Alternative Approach



Questions?

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