MARC Board of Directors
December 20, 2022

U.S. and KC Economic Forecast

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U.S. Economic Situation and Forecast

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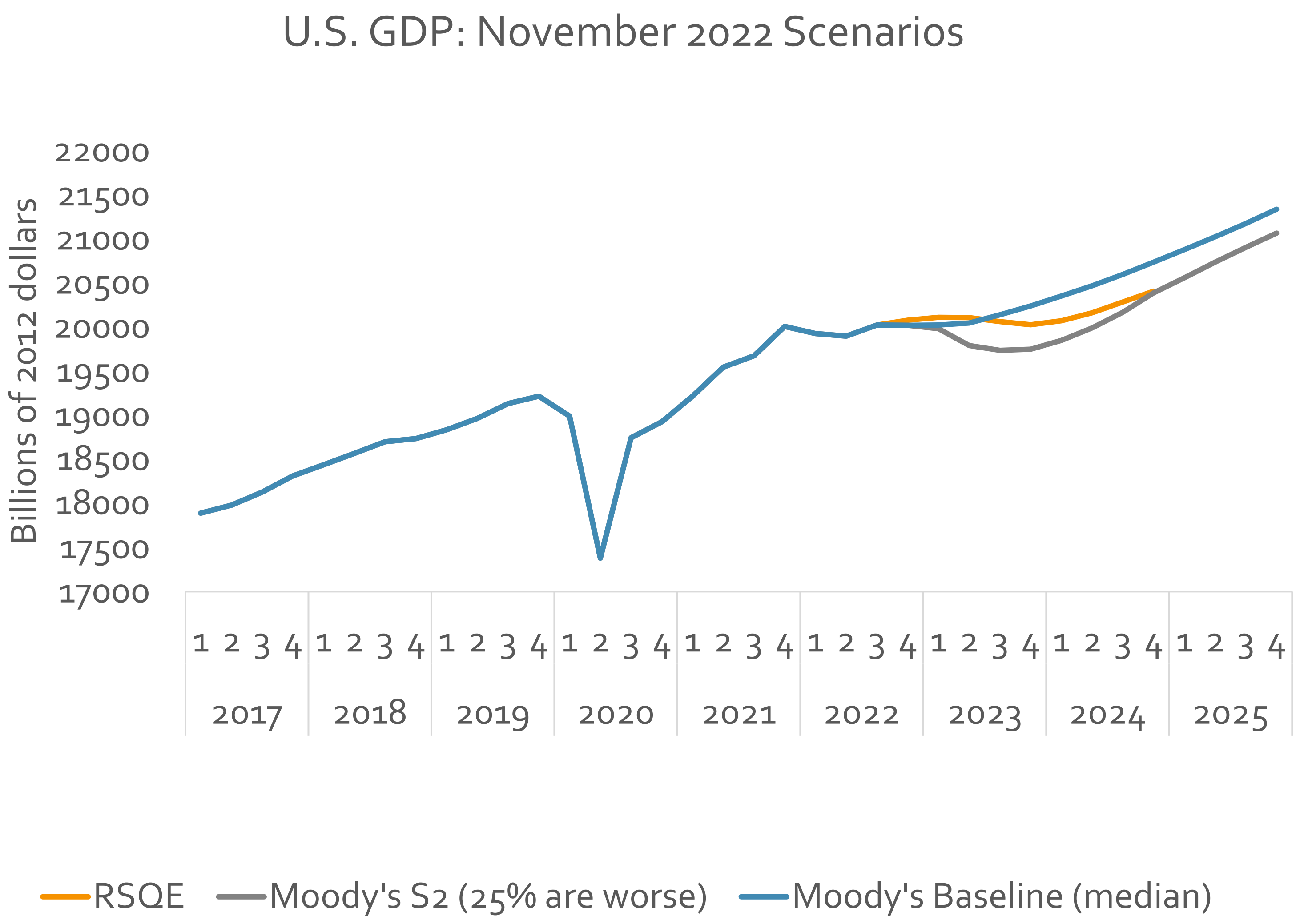
Moody’s Analytics:

November 2022 Assumptions for Baseline Forecast

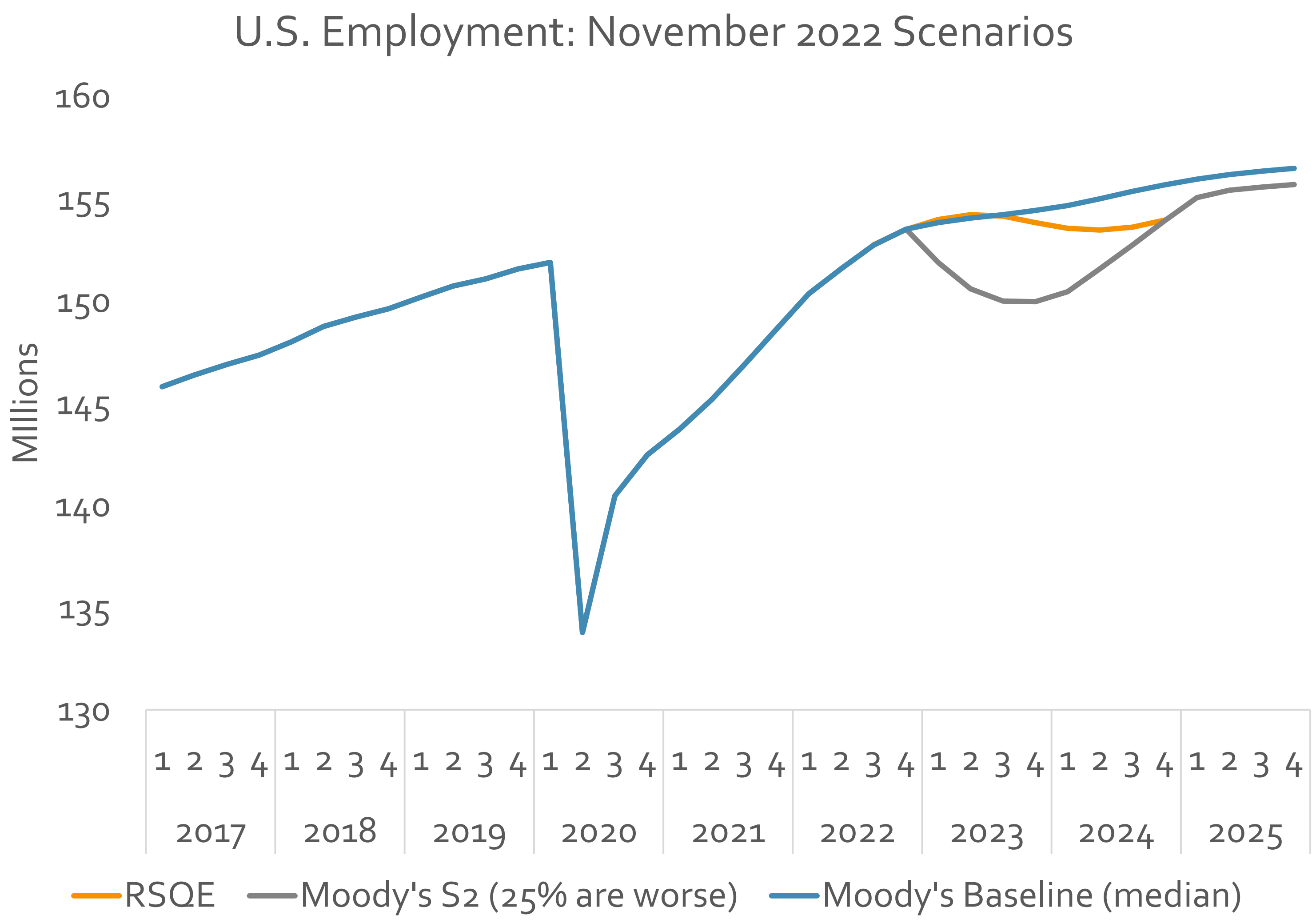
- The Fed will increase the funds rate another 75 basis points at the November meeting of the Federal Open Market Committee, 50 basis points at the December meeting, and 25 basis points at the meeting in late January. It is expected to peak at between 4.5% and 4.75% next year – nearly twice the level of the currently estimated “neutral” rate of 2.5%.
- Russa’s war with Ukraine won’t expand into other countries.
- Oil supply will be down between 2 and 3 million barrels per day compared to pre-pandemic causing oil prices to stabilize near $100 a barrel. It won’t be until mid-2023 that they gradually begin to trend down toward their equilibrium price of about $70.
- We assume the economy is currently at or near full employment - a 3.5% unemployment rate, a 62.5% labor force participation rate, and a prime-age employment-to-population ratio of at least 80%.
- There are no widespread lockdowns due to a new COVID variant.

Moody's believes a soft-landing – where the economy slows but does not decline – is still possible. This is its baseline forecast, which it gives a 50/50 chance of occurring. RSQE instead shows a mild recession beginning in the last half of 2023. Given the numerous ways in which something unexpected could happen, the RSQE forecast seems more likely.



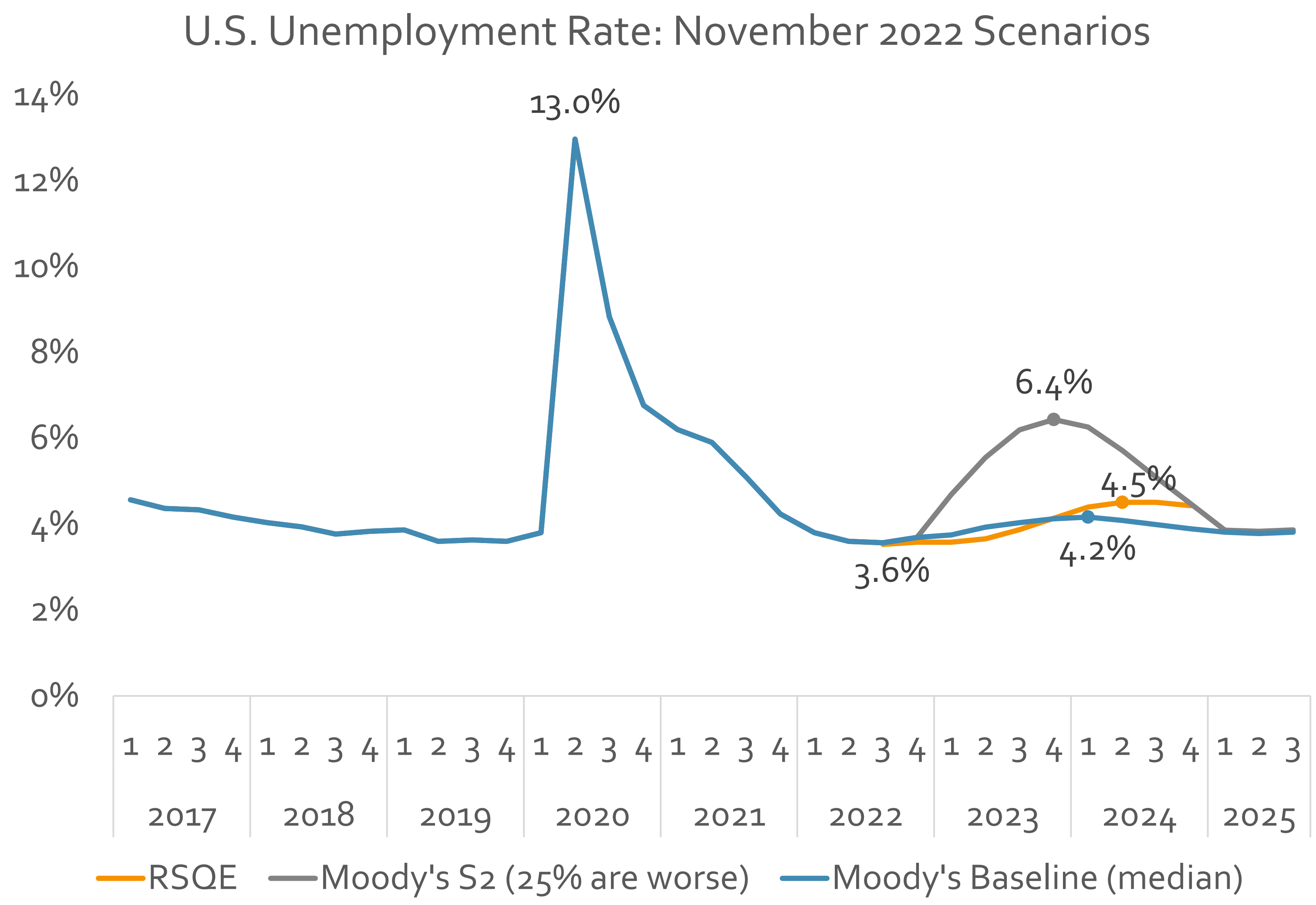
Source: Moody's Analytics

Moody's show flat employment growth, while RSQE shows a dip in employment beginning in the second half of 2023, resulting in a net loss of 680,000 jobs, peak to trough. A recession more average than mild – as shown in Moody's S2 scenario – could lead to a loss of 3.5 million jobs .



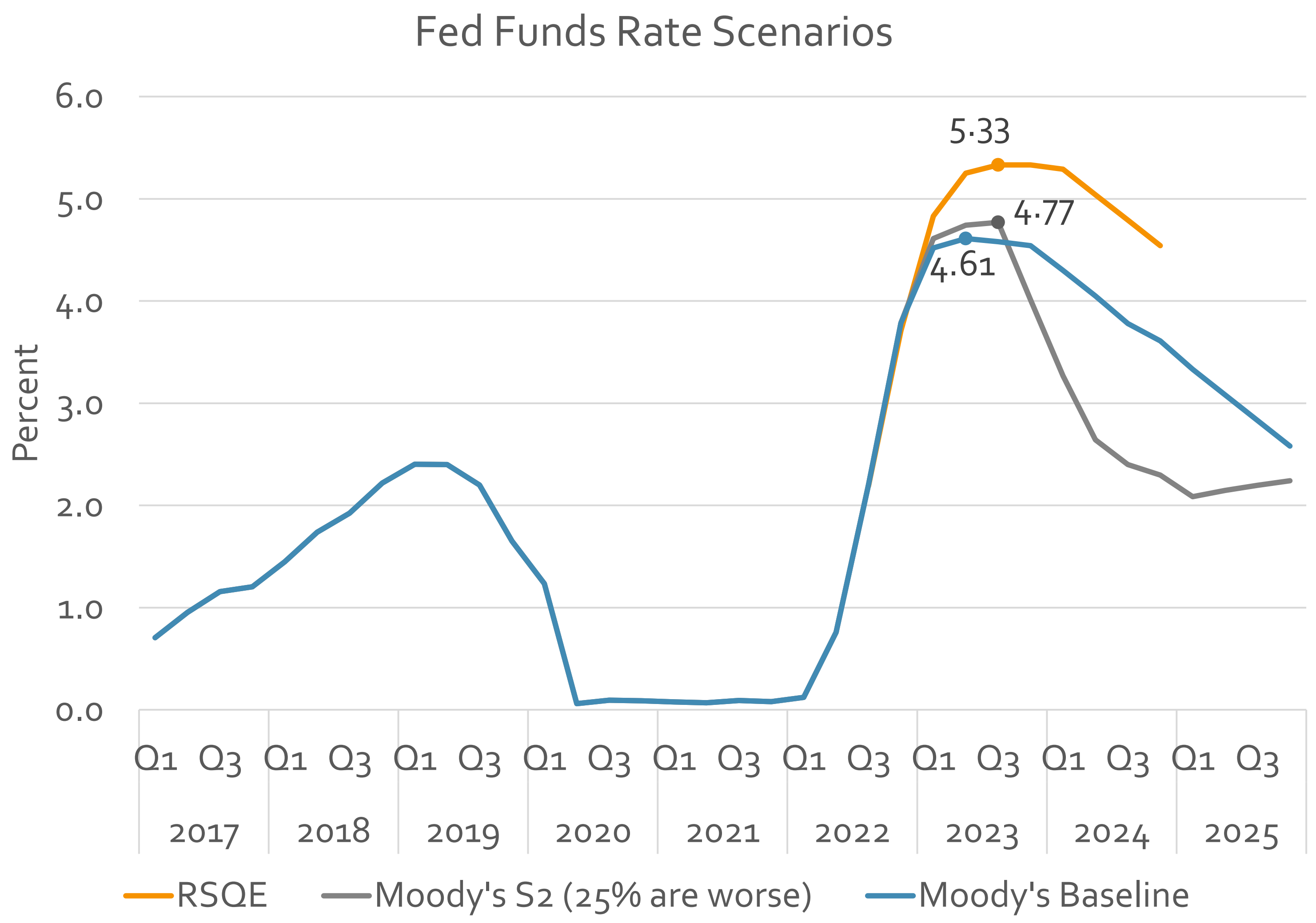
Source: Moody's Analytics

Moody's baseline forecast expects unemployment to rise ½ a percentage point to 4.2%. RSQE expects it to rise slightly more, to 4.5%. If the recession turns into one closer to average, this could push the unemployment rate to 6.4%.

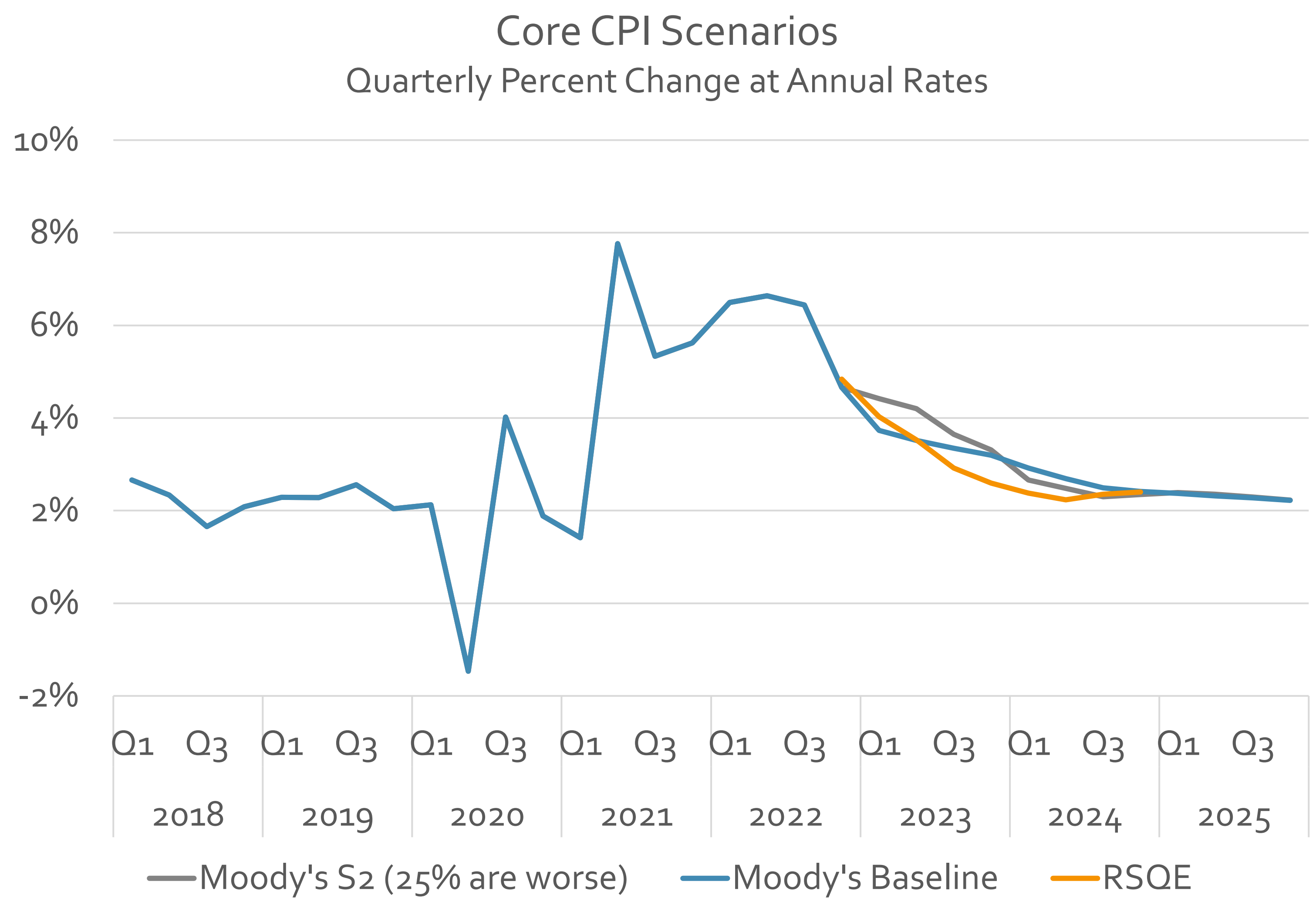


Source: Moody's Analytics

The Fed is likely to start reducing its pace of interest rate increases beginning in December. Moody's believes there will be a 1/2-point increase at that meeting, followed by a 1/4-point increase at the next, peaking at about 4.6%. RSQE thinks the Fed will need to be more aggressive, with the Fed Funds rate rising to between 5 ¼ and 5 ½ by third quarter in the last half of 2023 and remaining there for a year.



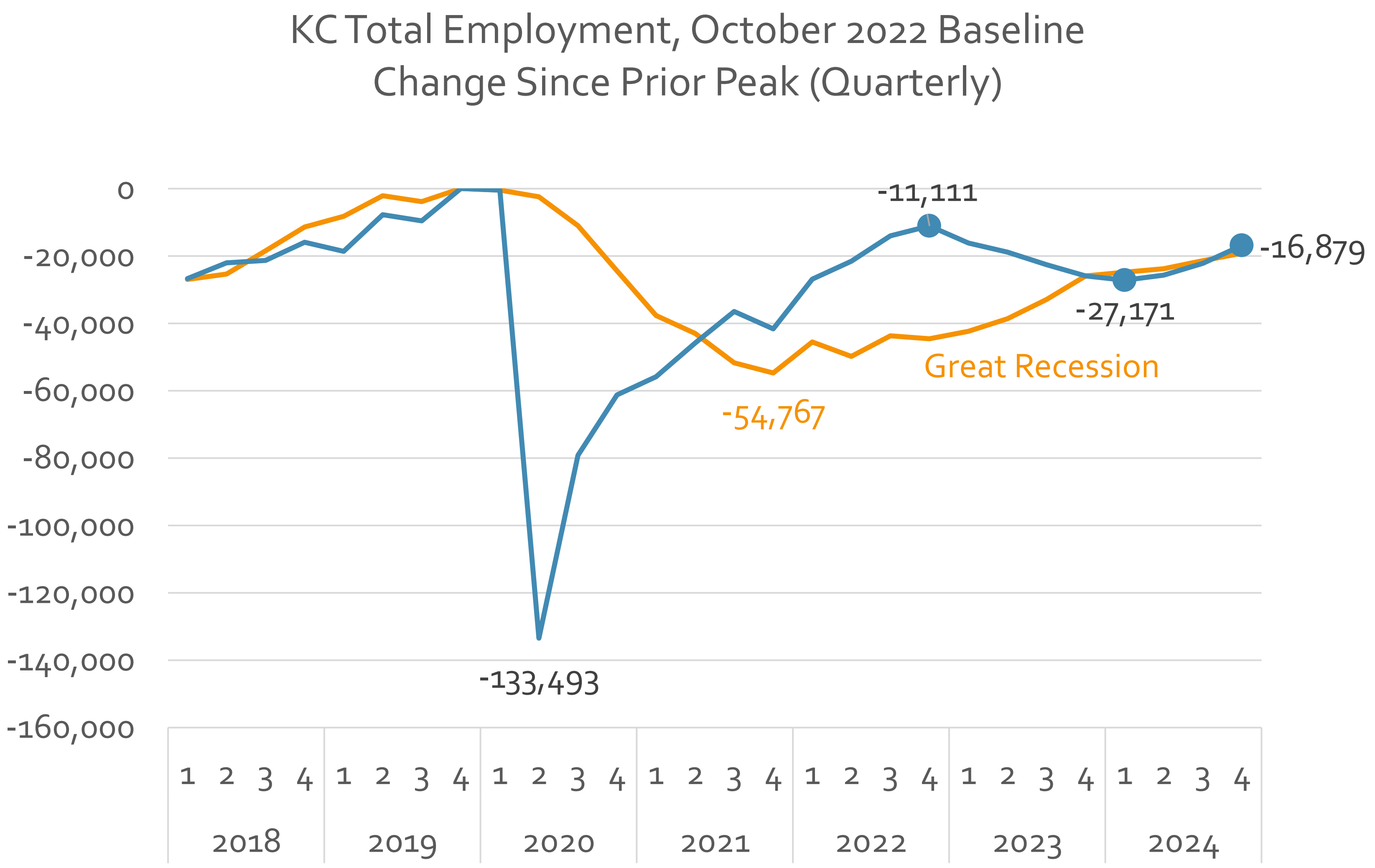
All forecasts expect a sharp reduction in inflation. Because RSQE's forecast keeps the Fed Funds rate higher for longer, it achieves a slightly faster reduction in core inflation (abstracting from volatile food and energy prices) and achieves the Fed's target by first quarter 2024. Moody's anticipates it will take until 3rd quarter.



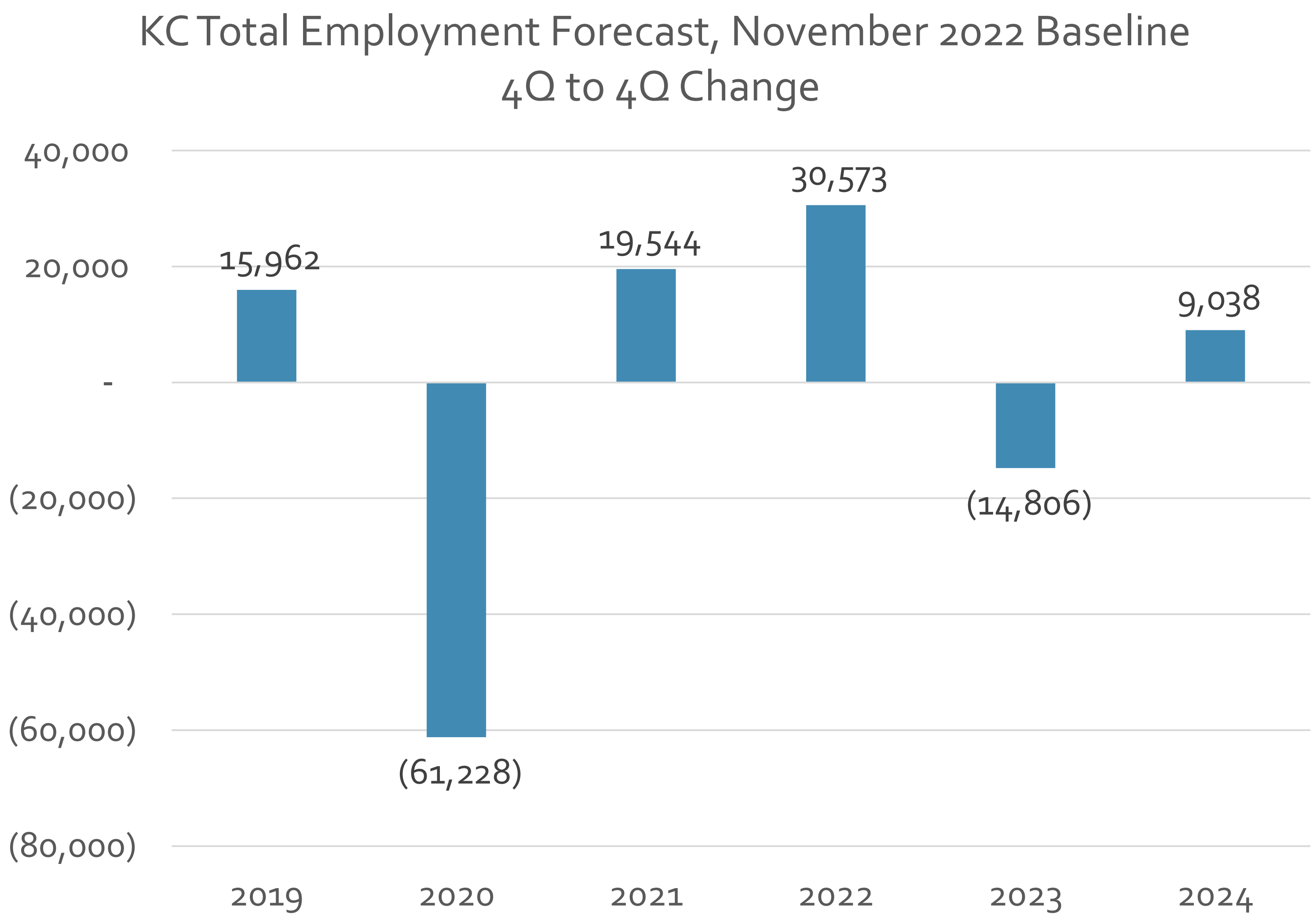
KC Economy – Forecast

Photo by Jake Fagan on Unsplash

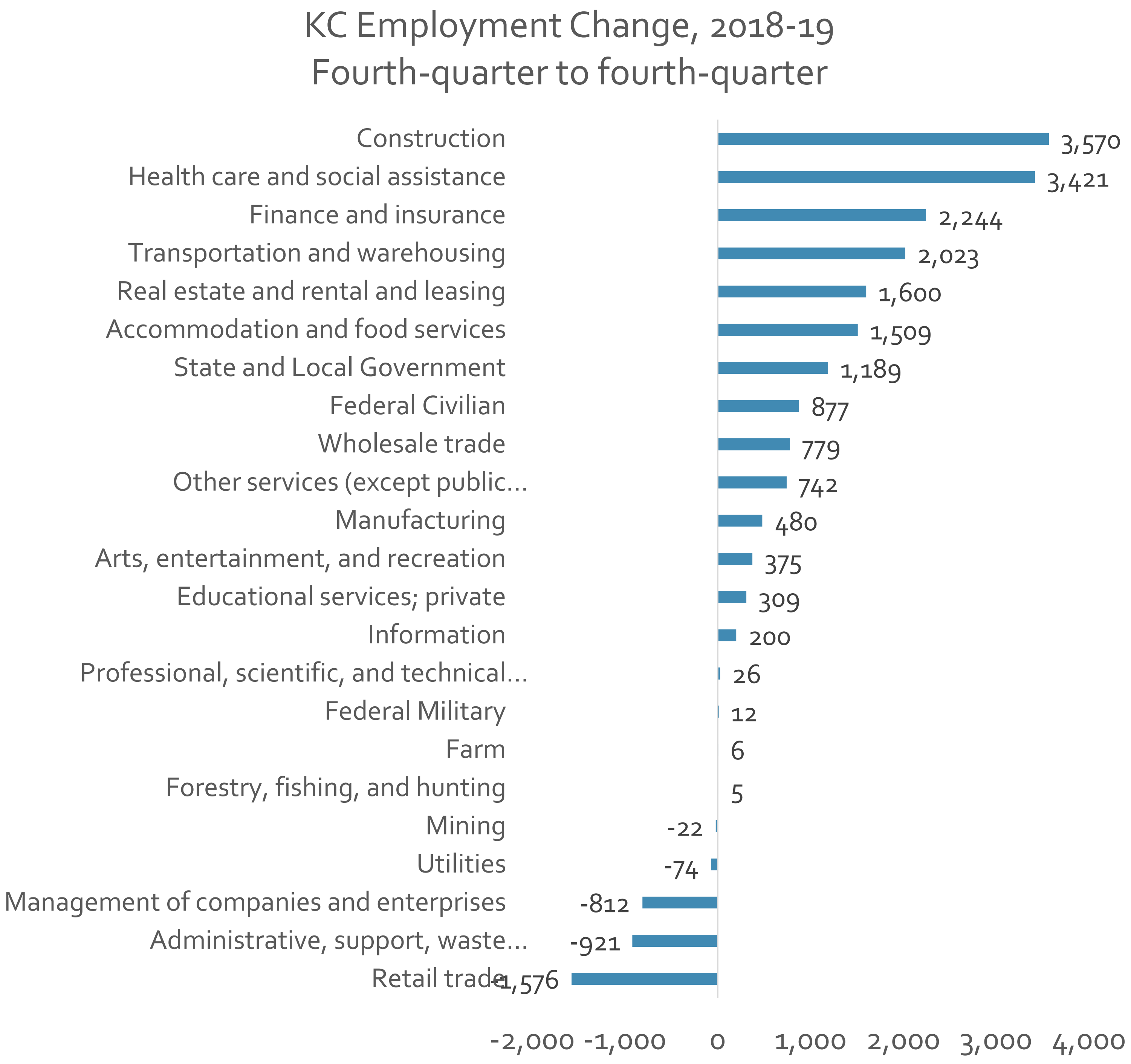
Based on the RSQE forecast, KC won't quite fully recover the jobs lost during the pandemic before they begin to fall again under the weight of a second recession. This one will be much milder, with a net loss of about 16,000 jobs peak to trough over the course of about 1 year beginning in 1Q 2023.



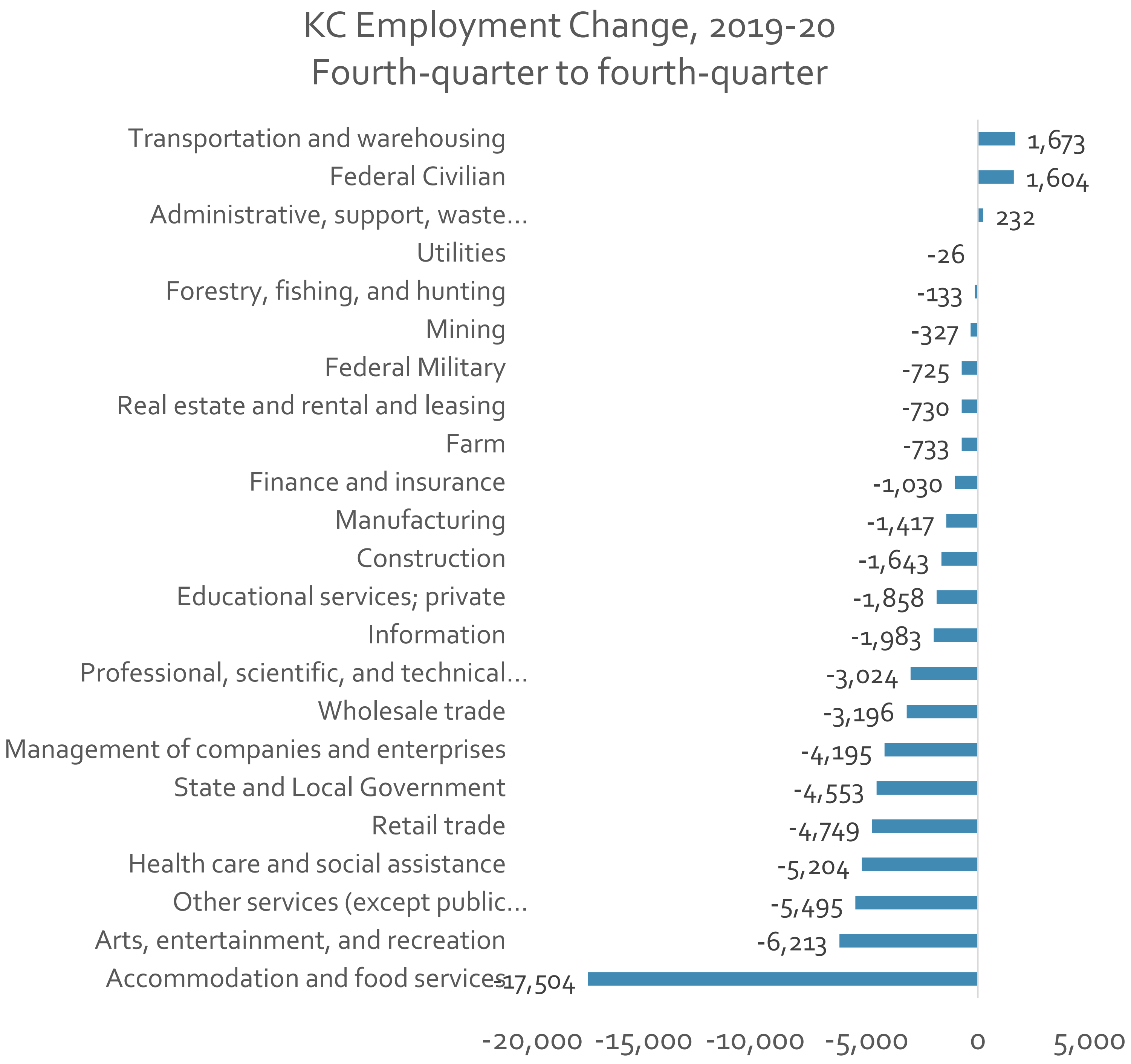
KC's employment growth began to accelerate just before the recession is expected to hit and cause a loss of about 15,000 jobs measured on 4Q-to-4Q basis. The economy begins to rebound after that, though national labor constraints may limit its strength. As a result, KC may not recover all its lost jobs until 2026.



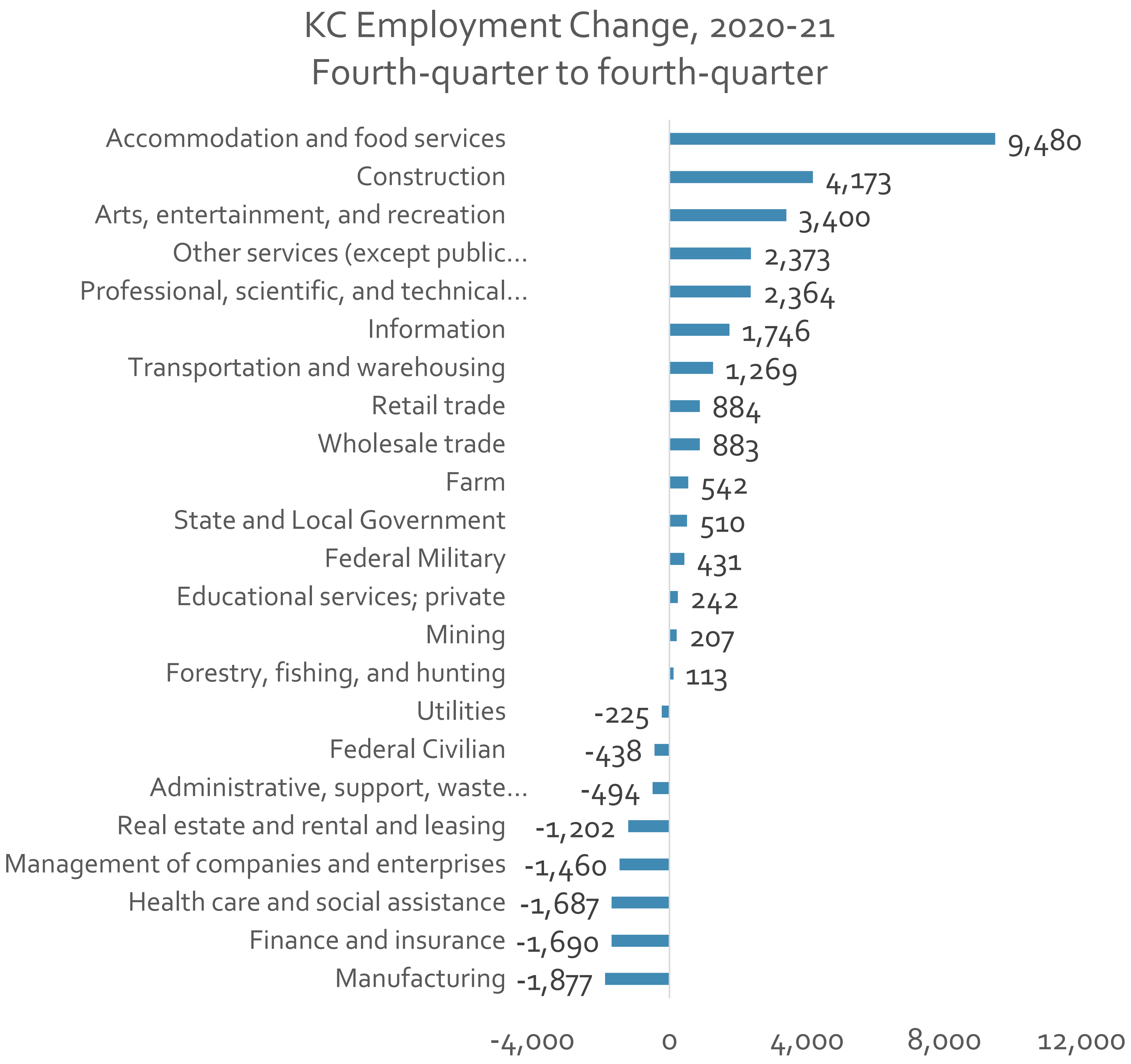
Taking this year by year, the 2018-19 period was the last one we might consider "normal". Growth in construction and Health Care led the way, while Retail continued to deal with the shift to on-line sales.



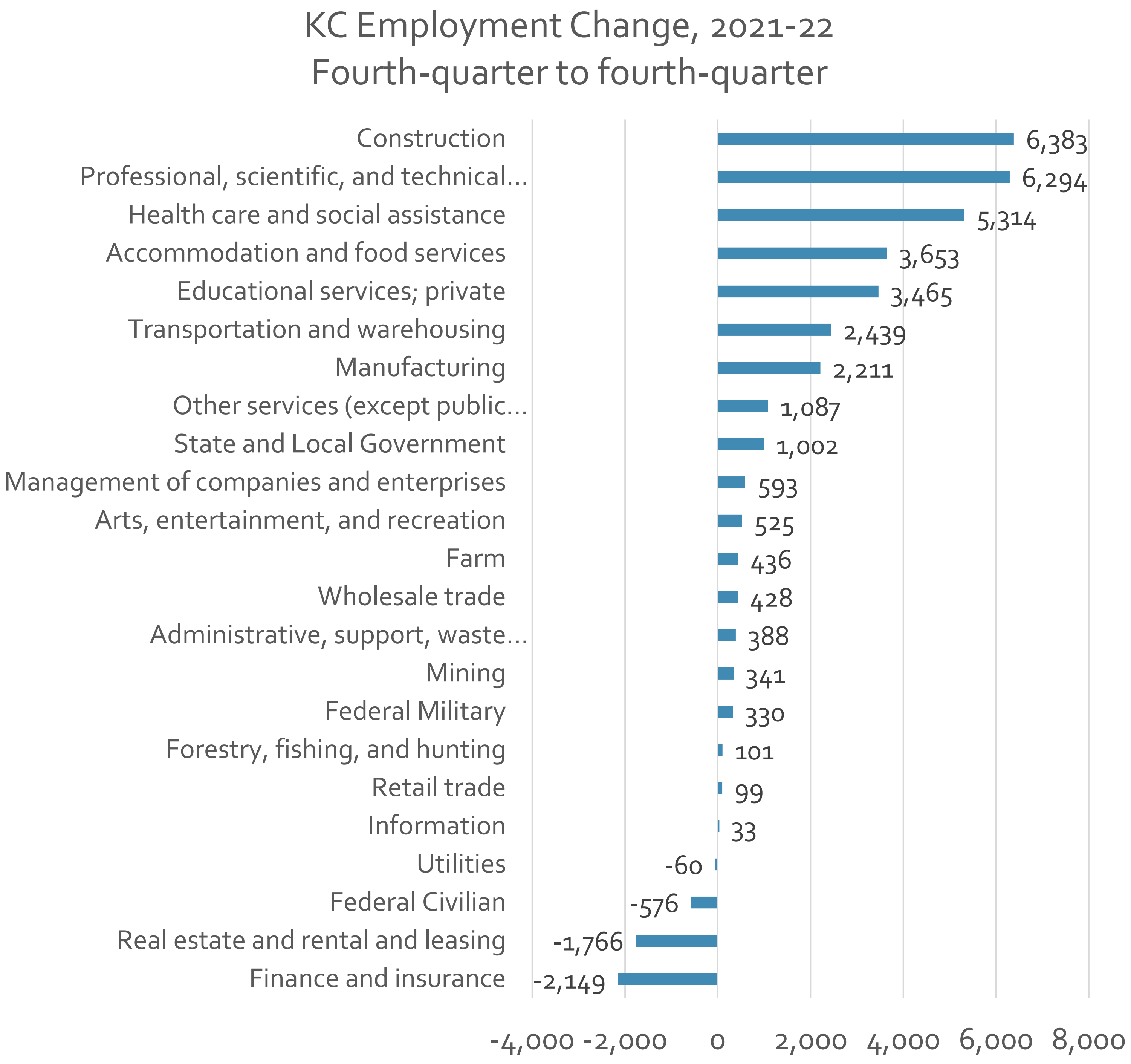
The world turned upside down in 2020 as a result of the Covid-19 pandemic and severe economic dislocations caused by sending all but essential workers home.



Despite the disruption, the economy began to grow rapidly as a result of several rounds of fiscal stimulus. Some of the sectors hit the hardest – like Accommodation and Food and Arts and Entertainment – also rebounded most strongly over the subsequent year.

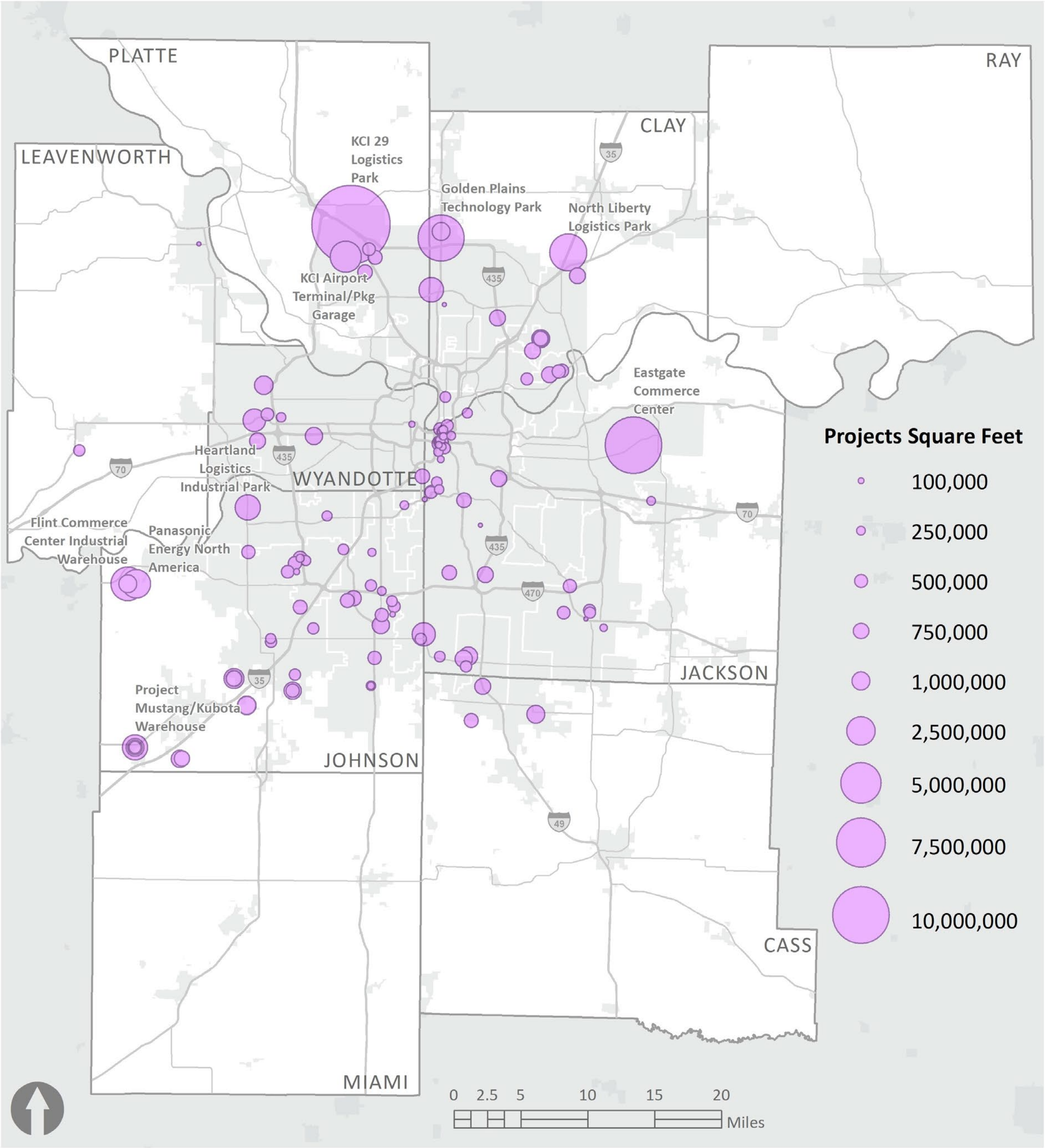


Growth became more widespread in 2022, with Construction, Professional and Technical services, Health Care, and Accommodation and Food leading the way. Finance and Insurance continued to decline. Despite a hot housing market in terms of prices, units sold began to drop this year as interest rates rose.

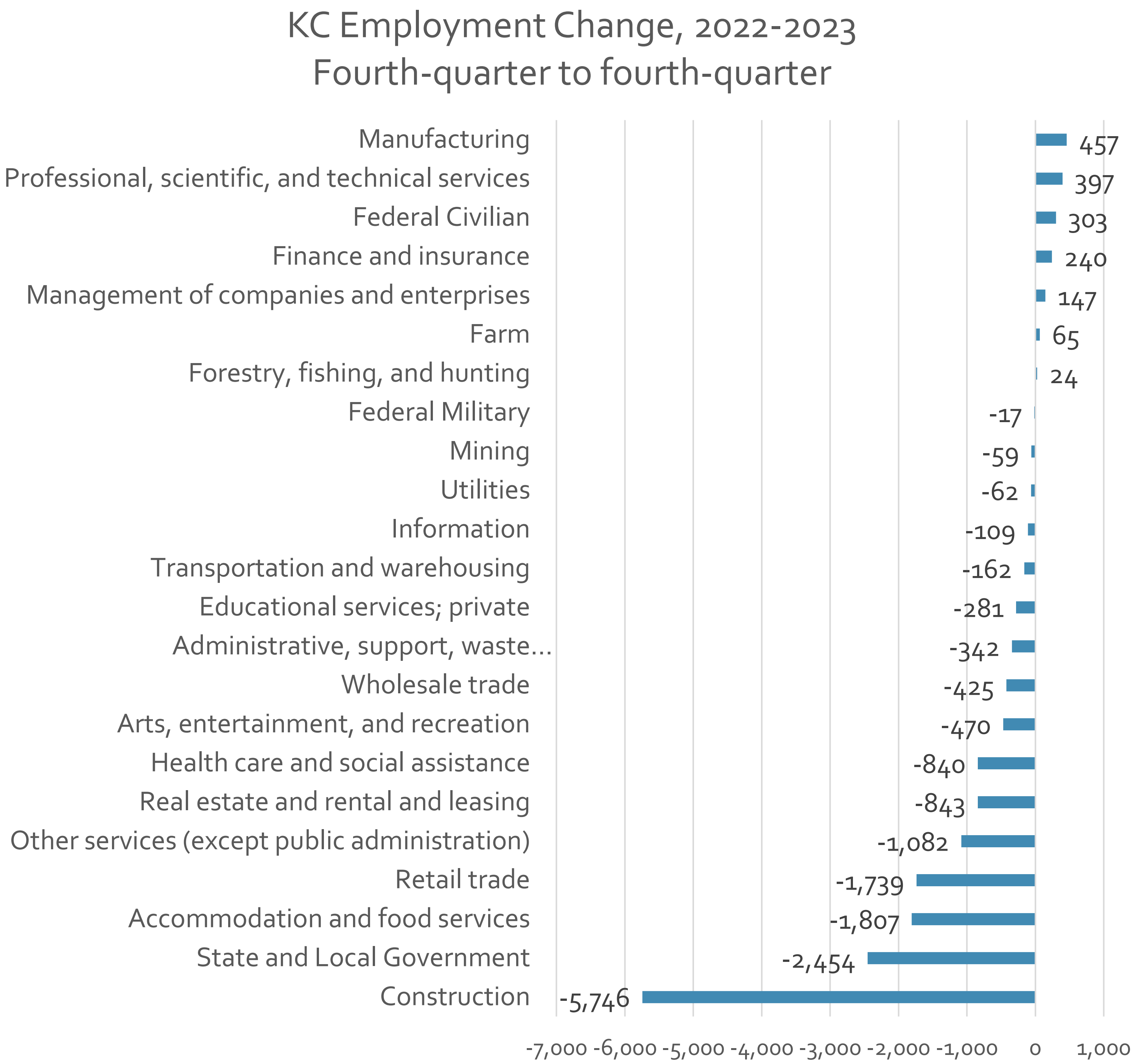


Much of the construction has been concentrated in the industrial and distribution sectors, with most locating near highways along and outside of the I-435 /I-470 Interstate loop.

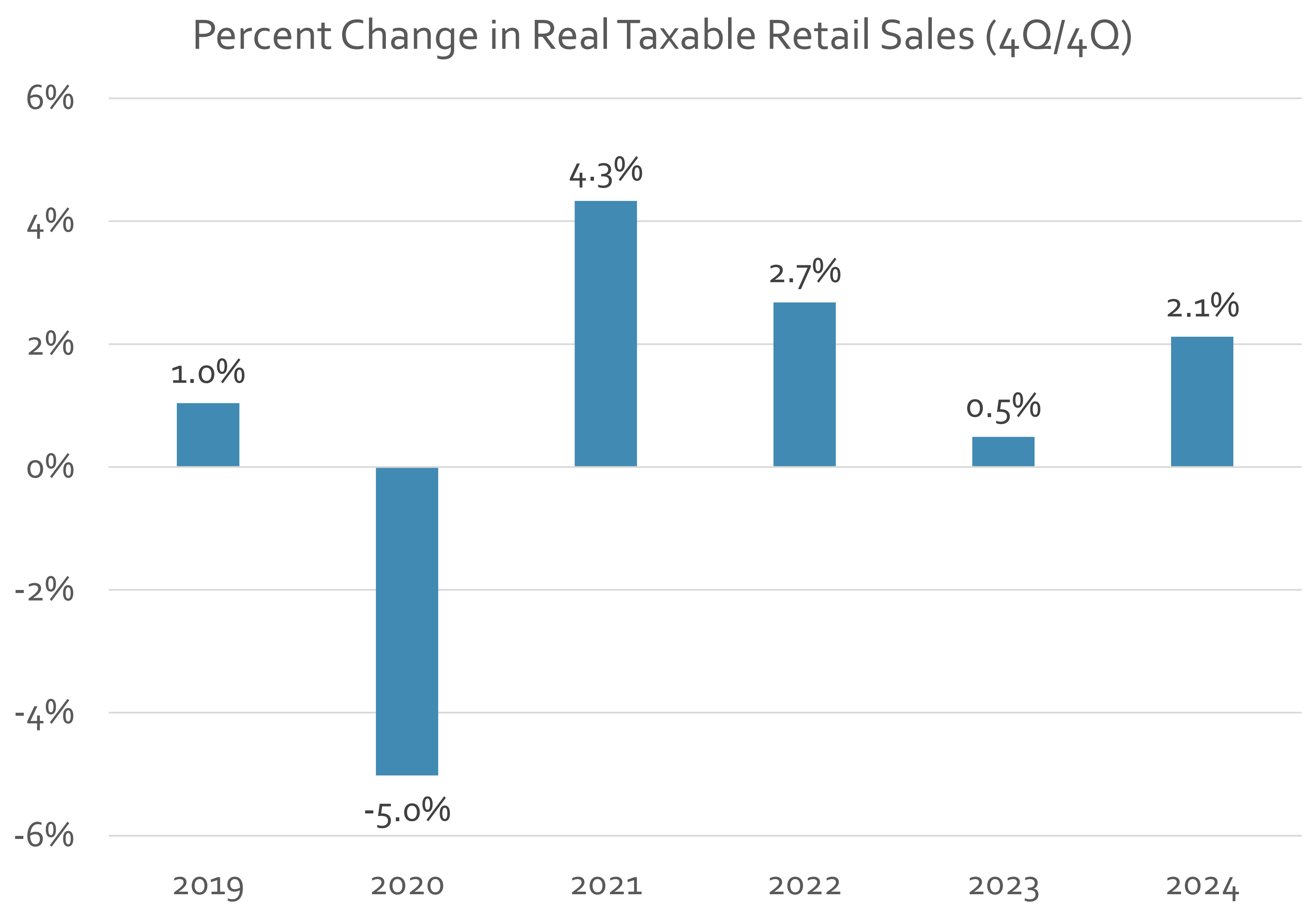
Largest current and planned construction projects in KC



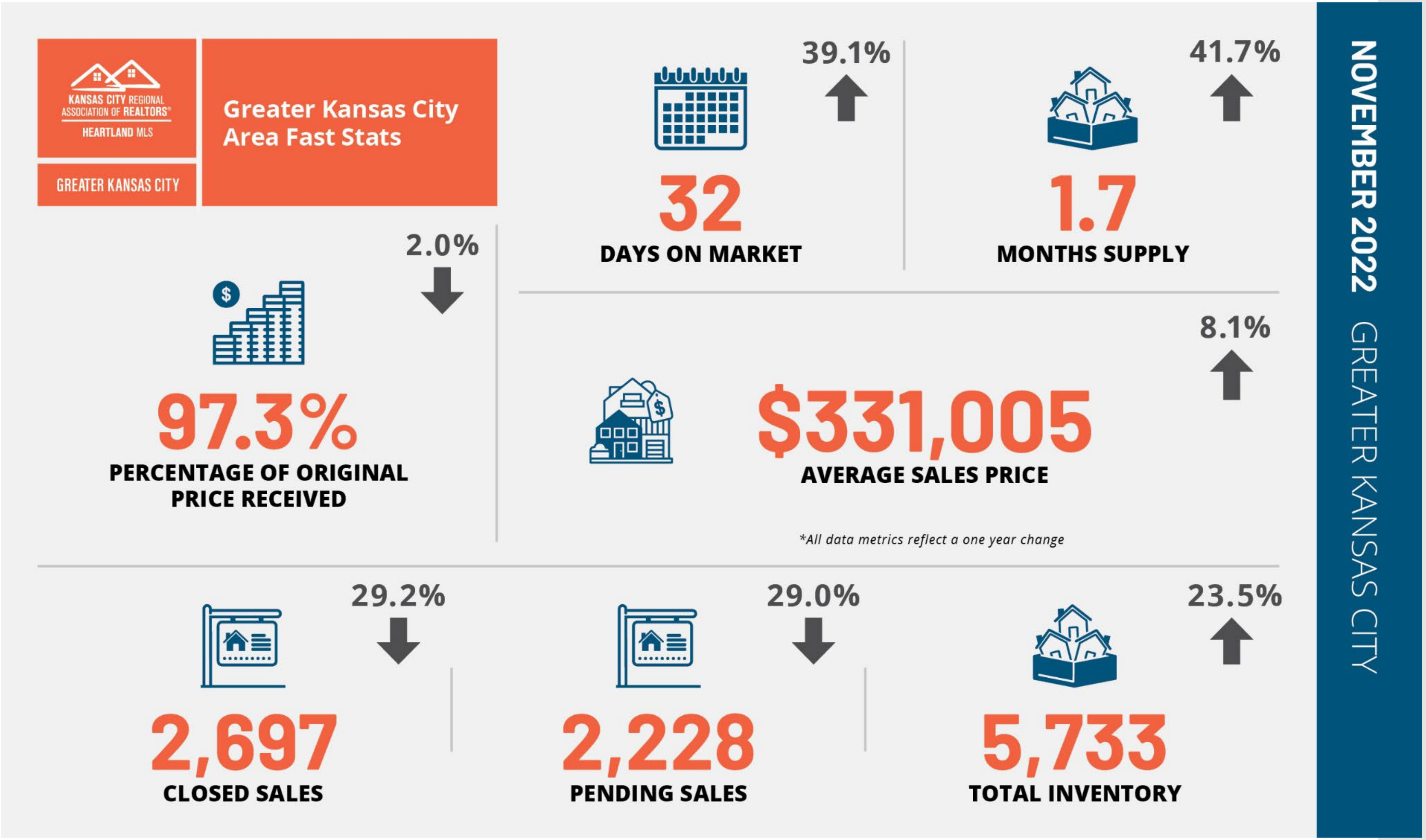
In 2023, the recession hits and takes most sectors with it. Construction employment falls the most in response to high interest rates. As spending growth is reduced, employment in Accommodation and Food and Retail decline significantly and stagnant revenues also hurt local government jobs.



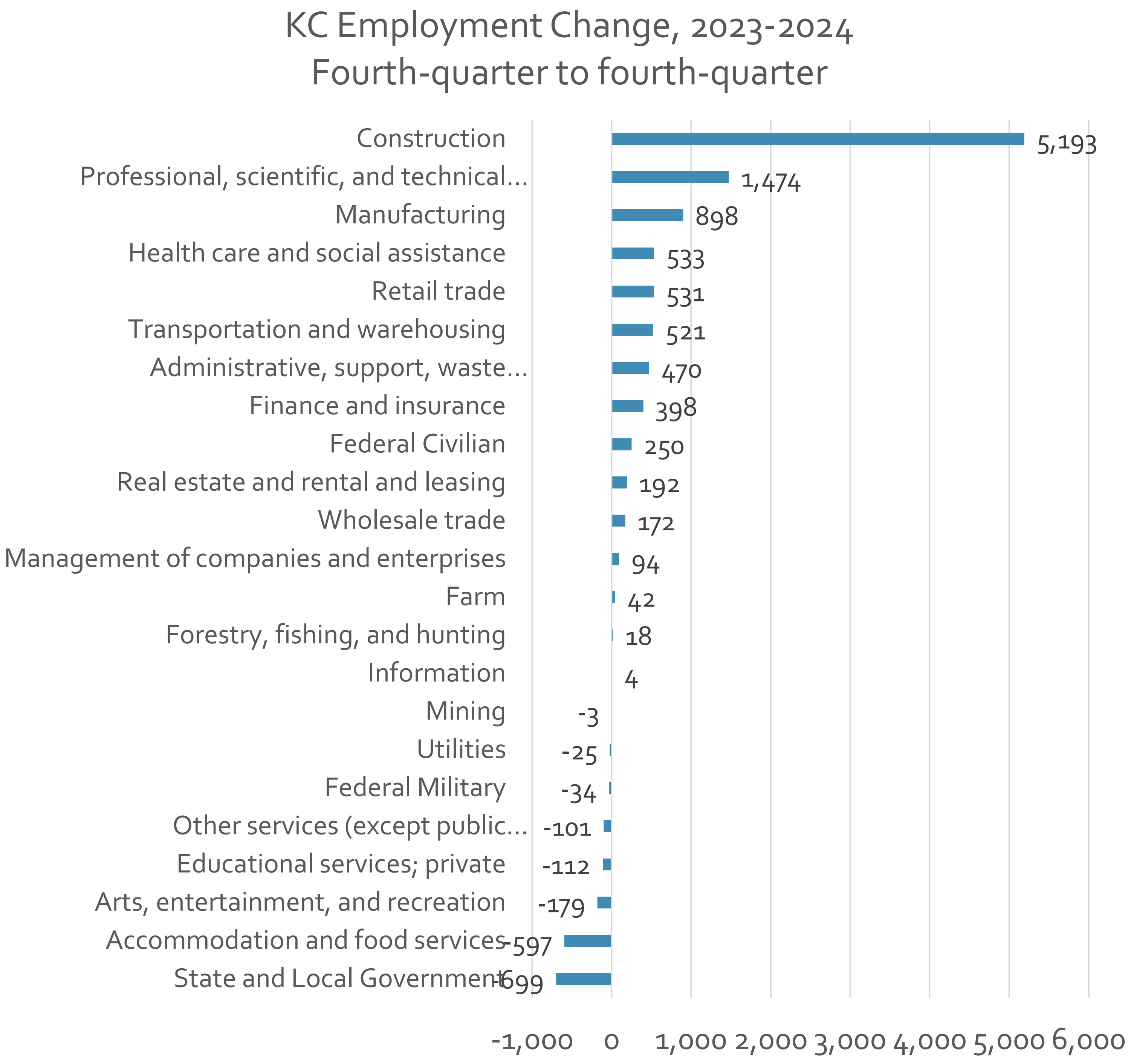
Why the decline in local government? Taxable retail sales follows a similar pattern to total employment, though the sales hold up a bit better than employment, avoiding an outright decline. Still, stagnant revenues in 2023 are likely to restrict local government ability to hire new workers or replace existing ones.



Property tax revenues are likely to be affected as well. Local residential real estate indicators confirm that the market for homes has already begun to cool significantly. While values have so far held up relative to one year ago, a slowing economy will put downward pressure on these as well.



In 2024, the rebound begins. But a mild recession means a mild recovery. Construction is expected to rebound strongly, as is Professional Services. Manufacturing shows strength in response to an improving global economy. But Local Government and Accommodation and Food continue to show lingering after-effects.



Summary and Conclusion

- The rapid rise in interest rates has already had an impact on the housing market, raising costs to the point where many consumers can no longer afford to purchase home.
- High interest rates have also added significant cost and instability into investment markets that were already dealing with the confluence of other sources of uncertainty. These include the potential for a "tripledemic," possible new supply-chain disruptions as China abandons its zero-Covid policy, rising geopolitical tensions created by the war in Ukraine, and increasing economic competition with China.
- With stimulus gone and excess savings dwindling, the consumer is unlikely to be able to plug the gaps in demand these factors are causing.

Summary and Conclusion

- As a result, we are forecasting a mild recession beginning in mid-2023. As it takes hold, inflation should come down. But a full recovery of jobs lost in KC during the pandemic may be postponed until 2026.
- Construction is hardest hit immediately but also is projected to rebound quickly. Manufacturing and Professional/Technical services show significant resiliency during this recession and help to lead the recovery.
- Despite the recession, worker and skill shortages in many occupations are likely to remain as the rate of retirements approaches the rate of new entrants and the rate of immigration remains historically low.
- The region's future economic growth is likely to depend on its ability to upskill its workforce so that it can be more resilient in the face of future disruptions, which appear to be occurring more frequently than in the past.

Summary and Conclusion

Despite experiencing slower growth than national and benchmark markets in the past, today KC is engaged in transformation:

- Attracting new visitors
  - The New KCI
  - 2023 NFL Draft
  - 2026 World Cup
- Growing new industries
  - Panasonic battery plant
  - Life Science Investment
- Creating a new, higher quality of life
  - Streetcar extension
  - Downtown baseball stadium

These investments have the potential to change the region's trajectory and accelerate its progress.

Discussion

- In the local figures you follow, do you yet see any evidence of a significant slowing of the economy? If so, where?
- In light of these forecasts, what kinds of things might you need to consider to successfully weather an economic downturn? What advice would you give to each other?

Questions?

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KC RISING
OUR SHARED VISION
FOR REGIONAL PROSPERITY

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