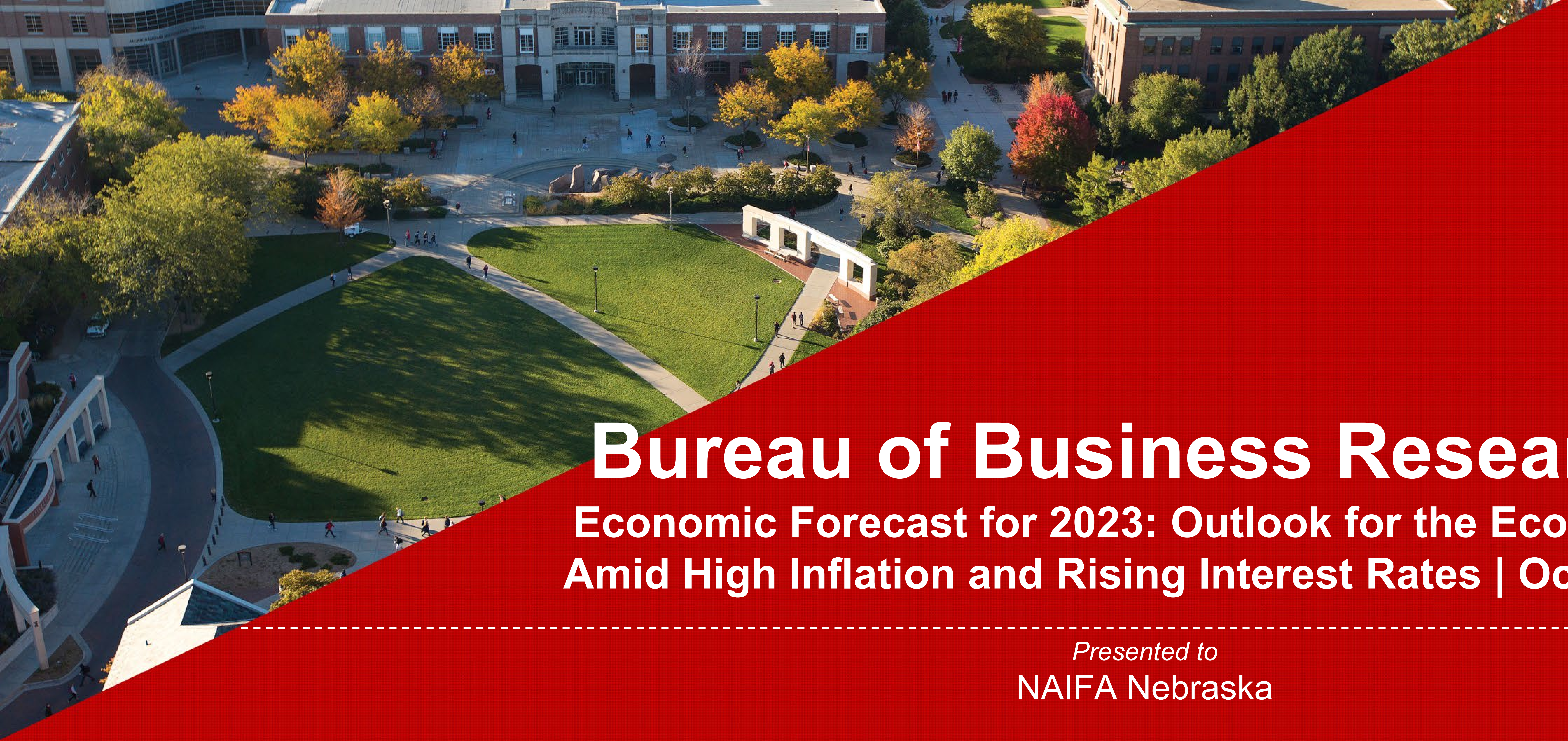

Bureau of Business Research

Economic Forecast for 2023: Outlook for the Economy Amid High Inflation and Rising Interest Rates | October 2022

Presented to

NAIFA Nebraska

Presented by

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Outline

- Outlook in a high inflation and rising interest rate environment
  - Implications for asset prices
  - Implications for manufacturing
  - Labor “hoarding” and macroeconomic conditions
- Implications in a food production state
- Nebraska economic outlook

Inflation

- Inflation has emerged as the leading economic issue

- Sources of inflation
  - Excessive Federal government spending
  - Central Banks slow in reacting to inflation
  - War in Ukraine
  - Policies creating a “shortage economy”

Inflation

- The result is stubbornly high inflation
- A wage-price spiral

Inflation

- The Federal Reserve Bank has a key role to play in reducing inflation

- The Federal Reserve will increase short-run and long-run interest rates.
  - Short-run: the Federal Reserve will raise the Federal Funds Rate and hold it at elevated levels
  - Long-run: The Federal Reserve will reduce its bond holdings

- Of note: higher interest rates imply a more valuable U.S. dollar

Property Values

- To fight inflation, the Federal Reserve must
  - Reduce asset prices
  - Otherwise reduce demand for goods and services
  - Reduce demand for labor - the Bank hopes to reduce job openings without reducing jobs

Property Values and Construction

- The Federal Reserve bank has a dual mandate to keep inflation low and employment rates high
  - The Federal Reserve will risk/tolerate a recession and falling employment to fight inflation, but still worries about employment

- By contrast the Federal Reserve does not worry about asset prices
  - As a result, the Federal Reserve is now "coming for" asset prices including the property market

Property Values and Construction

- Higher interest rates will reduce real estate prices and curtail demand in the economy (which discourages business investment)
  - In the housing market, demand destruction will be sufficiently severe to impact rents as well as home prices

- Construction input costs will moderate – this will buoy construction activity but there will be a decline in activity nonetheless

Property Values and Construction

- The drop in single-family home construction will be more modest given pent-up demand related to labor shortages
- The drop will be more severe in larger development projects
  - Multi-family housing – more homes offered for rent, more renters taking roommates, living with parents and downgrading to less expensive (i.e., older) rentals
  - Commercial and industrial sector projects – investment declines with falling demand

Implications for Manufacturing

- Higher interest rates imply a more valuable dollar, especially if the aggregate macroeconomy staggers along
  - This has implications for export-oriented sectors such as manufacturing
  - A higher value dollar will be a substantial drag on sectors of the manufacturing industry that “fully” compete in the international markets
- However, impacts may be more limited for food processing

Implications in a Food Commodity State

- Nebraska specializes in food processing and food commodity production
  - The state has benefited from food inflation and elevated crop commodity prices.
  - Higher input costs, however, have reduced the benefit.
- A specialty in food commodity production will remain a benefit even under rising interest rates and a rising dollar.
  - Input costs related to energy will fall faster like food commodity prices

Implications of "Labor Hoarding" for the Macroeconomy

- Job loss is a core characteristic of a recession
  - Falling income from work accelerates the decline in demand

- Falling demand may not lead to net job loss under current conditions
  - In particular, the old idea of "labor hoarding" may play a key role in U.S. macroeconomy over the next few years

What is “Labor Hoarding?”

- Labor hoarding is when businesses retain key workers in an environment of falling demand even though it hurts profits

- According to this perspective, profits will be greater in the long-run since key workers will be available and knowledgeable about their current job when faster growth returns

Implications of “Labor Hoarding” for the Macroeconomy

- For most businesses, hiring has been extremely difficult in recent years <u>for all types of workers</u>
  - Even moderate skill workers have been difficult to find

- In this unusual environment, employers may perceive that most workers are “key workers”
  - Businesses may be more inclined than in the past to keep (“hoard”) workers despite falling demand and profits

Implications of “Labor Hoarding” for the Macroeconomy

- The hoarding of workers by a larger share of businesses implies that job loss may not accelerate the decline in demand in the coming few years
  - The U.S. economy may stagger along rather than fall into a significant recession in 2023

Macroeconomic Outlook for 2023

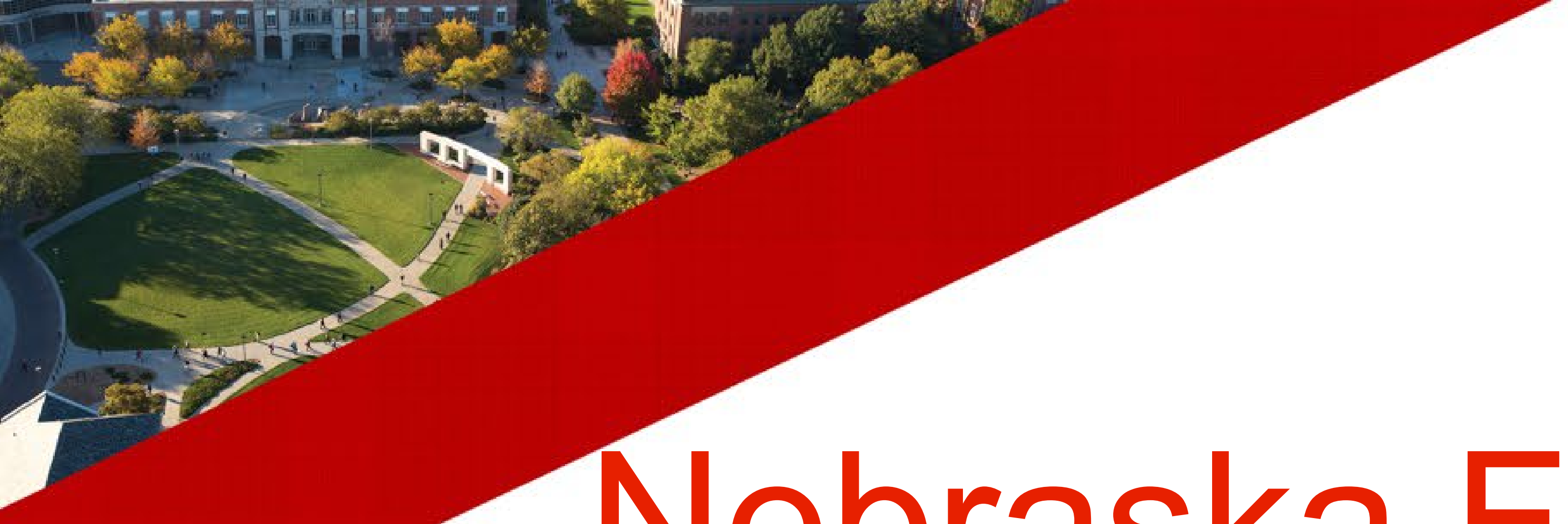
Measure	2023
Growth in Real GDP	0.0%
Inflation	4.0%
Federal Funds Rate	5.0%

Implications for the Nebraska Economy

- What about the Nebraska economy?
  - Nebraska construction activity and employment will fall
  - Manufacturing activity will remain steady (with employment dropping slightly) given the state’s orientation towards food processing

Agriculture

- The more valuable U.S. dollar also will put downward pressure on some ag. commodity prices and the prices of some ag. inputs
  - Crop prices will fall (-5% to -15%)
  - Livestock prices will rise (0% to 5%)
  - Fertilizer, fuels and oil may fall (0% to -10%)
  - Other Intermediate goods, labor will rise (0% to 5%)
  - Interest expenses will rise (10% to 20%)



Nebraska Farm Income

- Nebraska Net Farm Income 2023: Remains near record level of $8 billion, down 1%
  - Farm receipts: -3%
  - Direct government payments: -58%
  - Total expenses: -0.5%
  - Positive inventory adjustment leads to just -1% change in net farm income

Source: Nebraska Farm Income Outlook, Fall 2022, Rural and Farm Finance Policy Analysis Center, University of Missouri and Center for Agricultural Profitability, University of Nebraska-Lincoln

Other Sectors

- Other select sectors
  - Retail Trade
  - Services

Retail Trade

- Retail trade will be impacted by modest demand

- Retail Trade employment will be impacted especially due to
  - On-line shopping
  - Automation (for example: self check-out)

- Retail trade employment will fall by 0.5% in 2023

Services

- Demand for business services will moderate given slower economic growth
  - “Pent up” demand for leisure and entertainment allow employment to grow in this sector
  - Health care activity and employment grows steadily

- Service employment will grow by 0.7% in 2023

Total (Non-Farm) Employment Outlook

	Annual Rate of Growth 2023
Growth in Nebraska Employment	0.3%
Growth in Nebraska Real Non-Farm Income	0.5%

THANK YOU!

Any Questions?