



Economic Trends 2023: In Search of the New Normal

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Agenda

- Review of 2022 Predictions
- Review of 2022 Economic Performance
- U.S. Outlook for 2023 and Beyond

Review of 2022 predictions

- We can still thread the needle on inflation and recovery, but uncertainty will make it a wild ride.
- Real GDP growth 3.5%, unemployment below 4% with greater labor force participation at year end.
- Core inflation of 3.8% y/y in December 2022.
- S&P may end lower than we started due to rate hikes but remains a great long-term play (we are still about 18% ahead of where I thought we would be a year ago!)

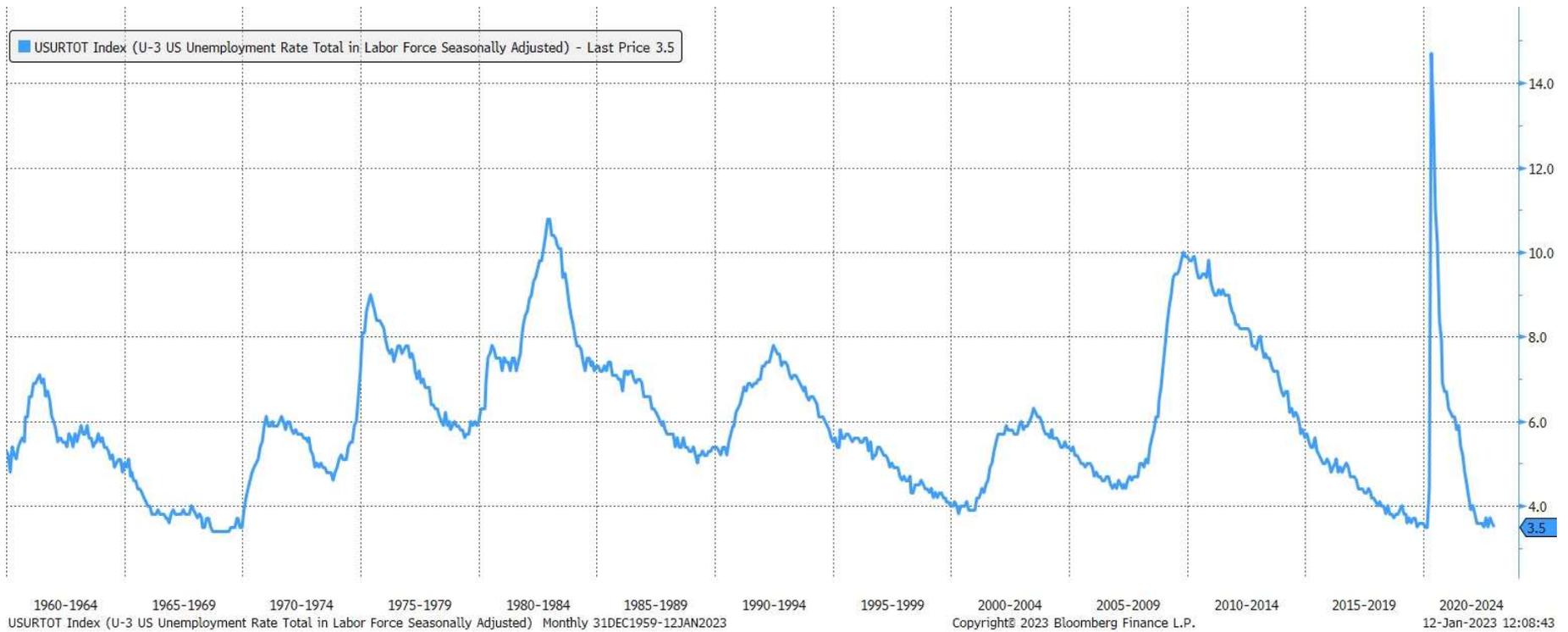
What we missed in 2022 forecast

- Russian invasion of Ukraine added to pandemic related adverse supply shocks.
- Heightened tensions with China along with continued zero COVID policy.
- U.S. labor supply never got back to pre-pandemic levels of participation.
- This added up to more inflation (+2.5%) and less growth (-1.5%) than I had expected.

Unemployment has plummeted but...

USURTOT Index (U-3 US Unemployment Rate Total in Labor Force Seasonally Adjusted)

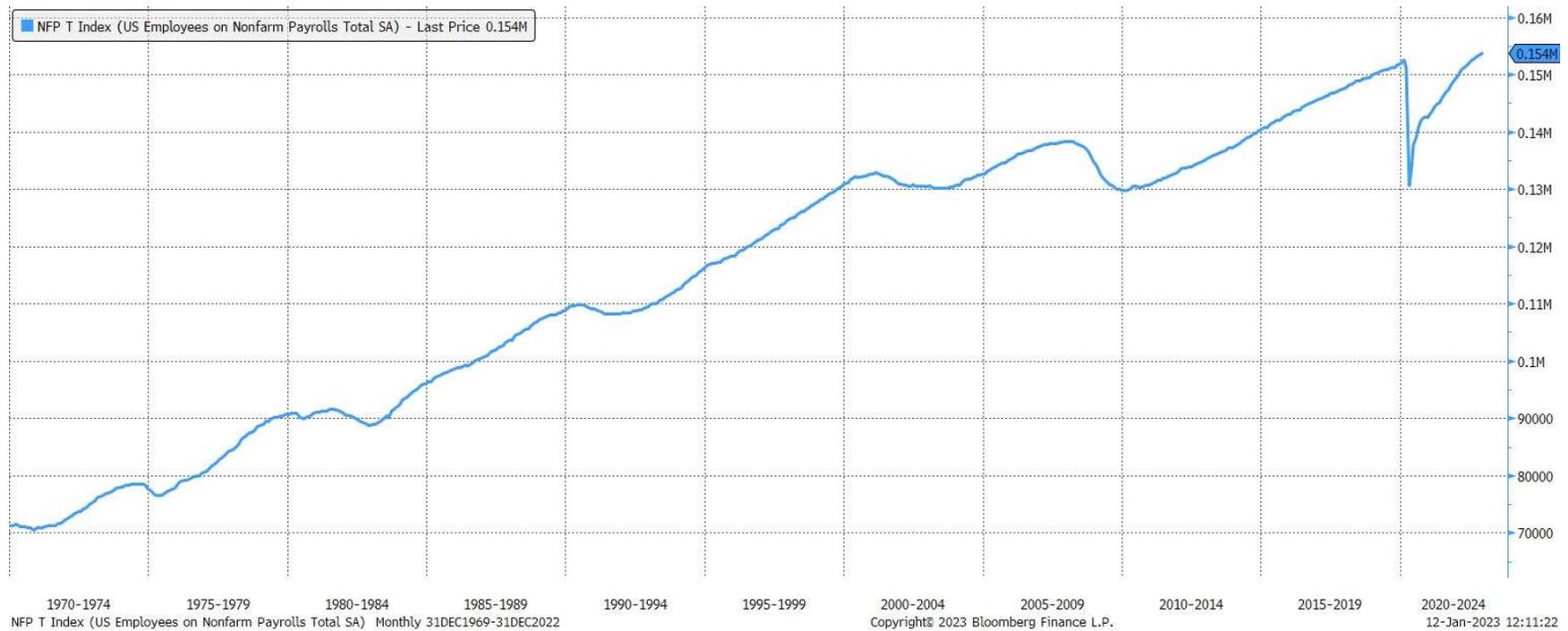
Bloomberg



Payroll employment barely above peak

Bloomberg

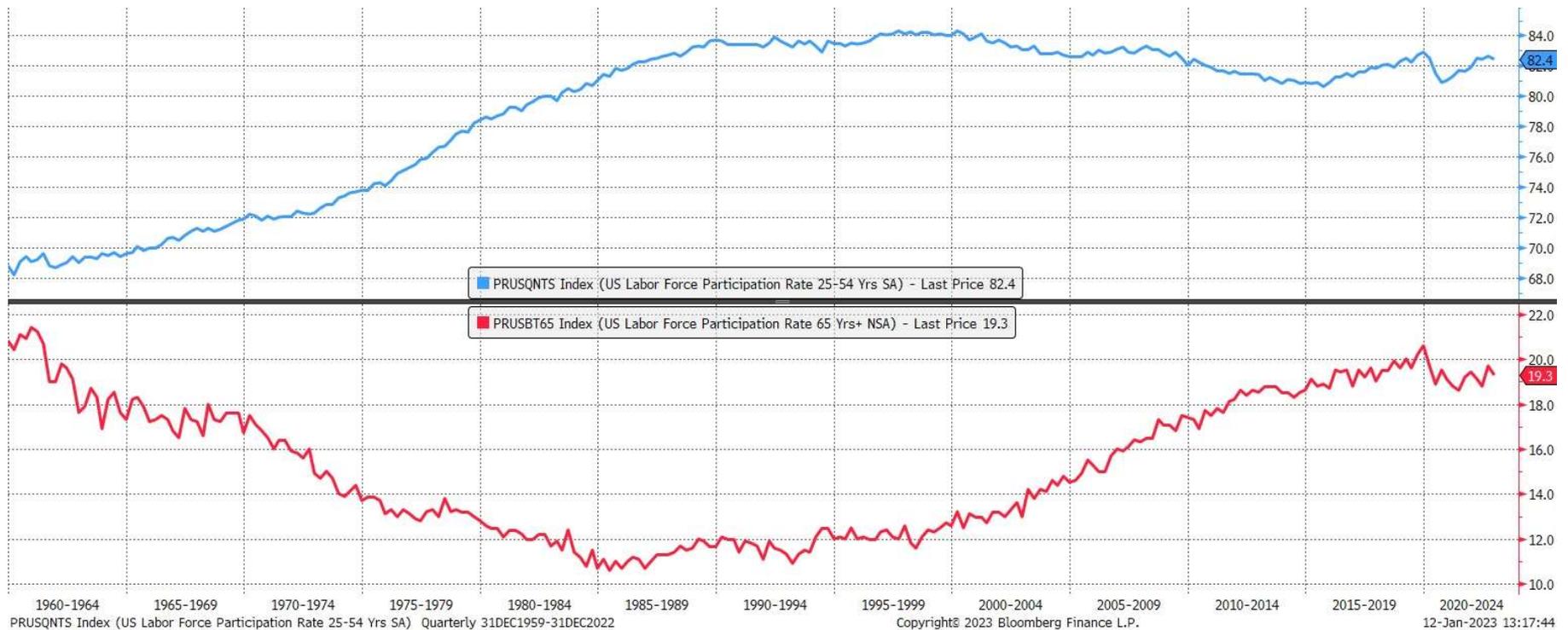
NFP T Index (US Employees on Nonfarm Payrolls Total SA)



Labor force participation: still not back

PRUSQNTS Index (US Labor Force Participation Rate 25–54 Yrs SA)
PRUSBT65 Index (US Labor Force Participation Rate 65 Yrs+ NSA)

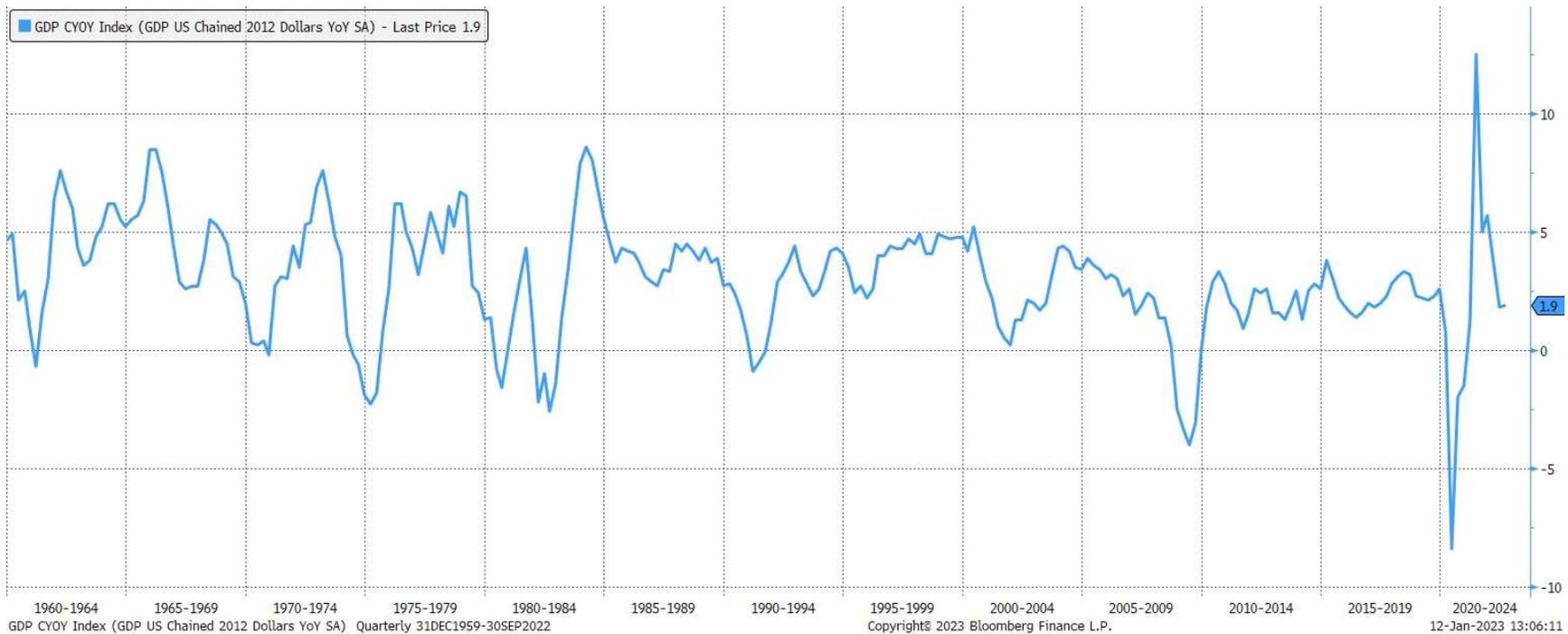
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Real GDP growth: new lower normal ahead

GDP CYOY Index (GDP US Chained 2012 Dollars YoY SA)

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U.S. and global equities: major repricing

SP Index (S&P 500 Index)
MXWO Index (MSCI World Index)

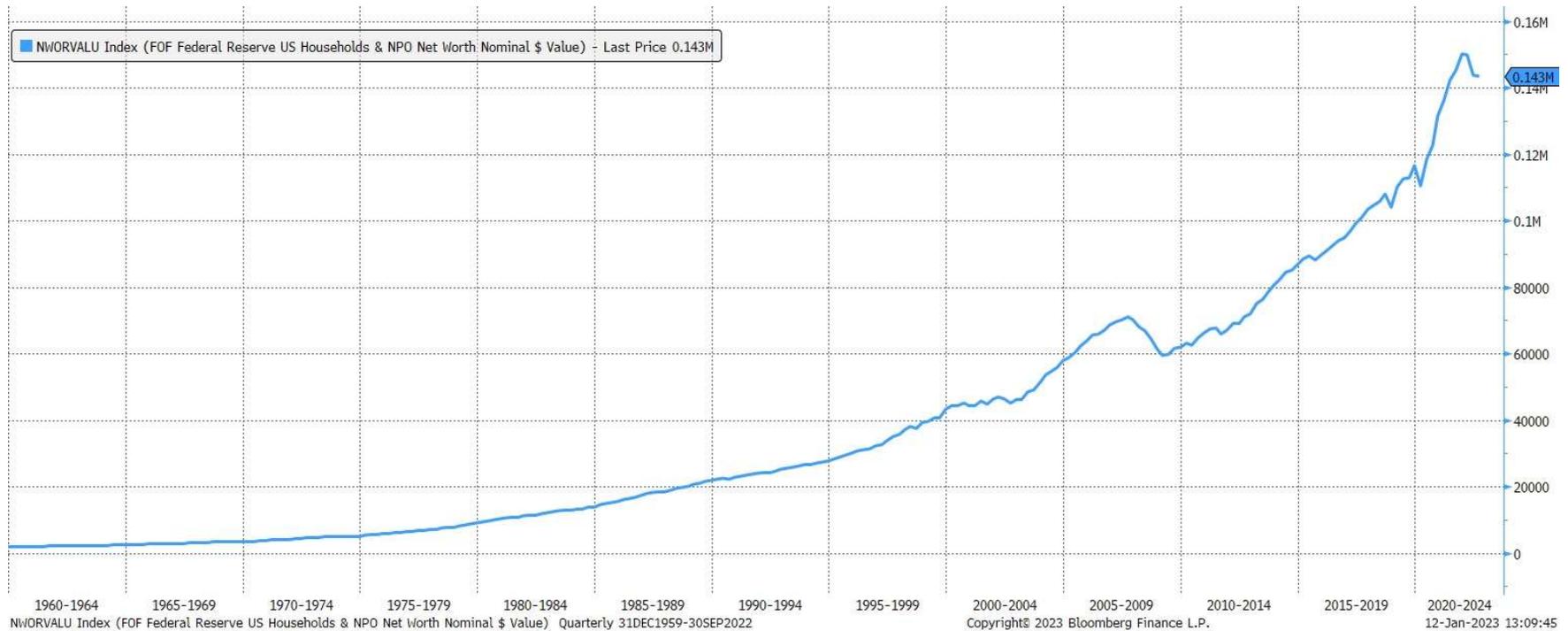
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Household net worth reduced but high

NWORVALU Index (FOF Federal Reserve US Households & NPO Net Worth Nominal)

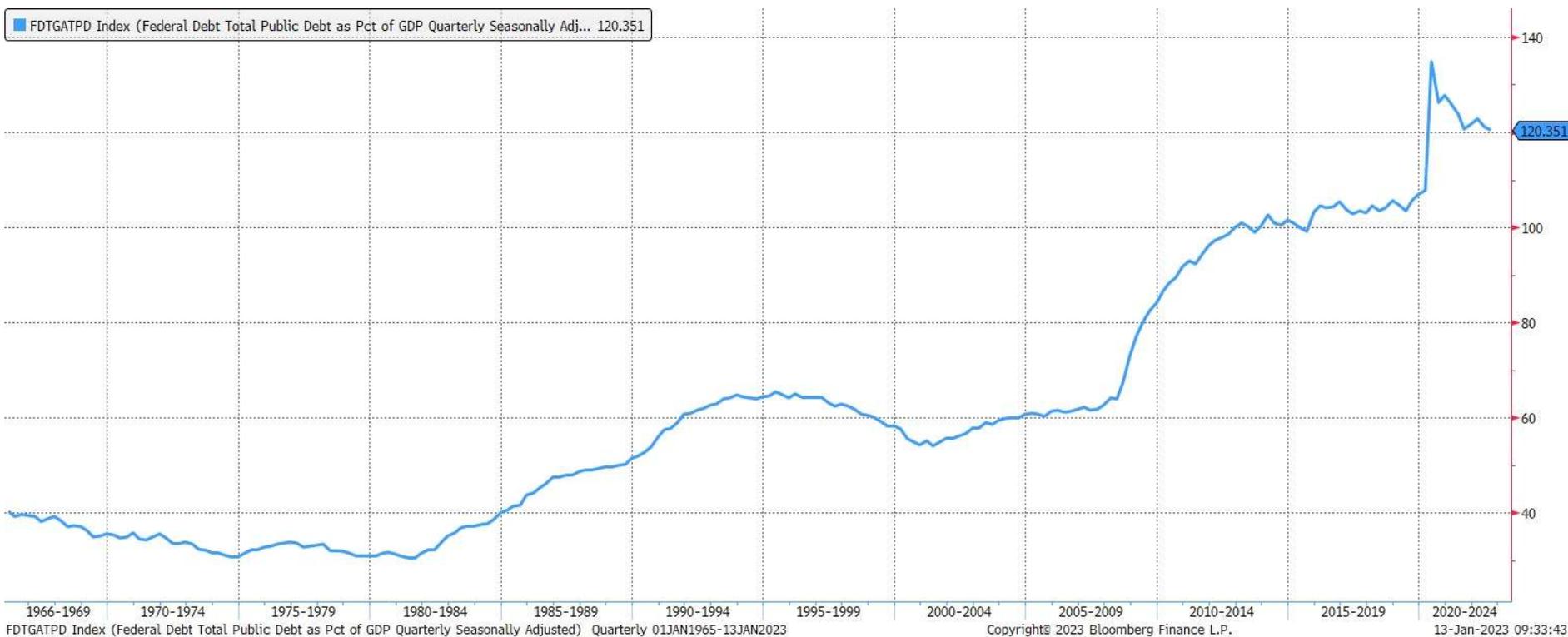
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Federal debt to GDP

FDTGATPD Index (Federal Debt Total Public Debt as Pct of GDP Quarterly SA)

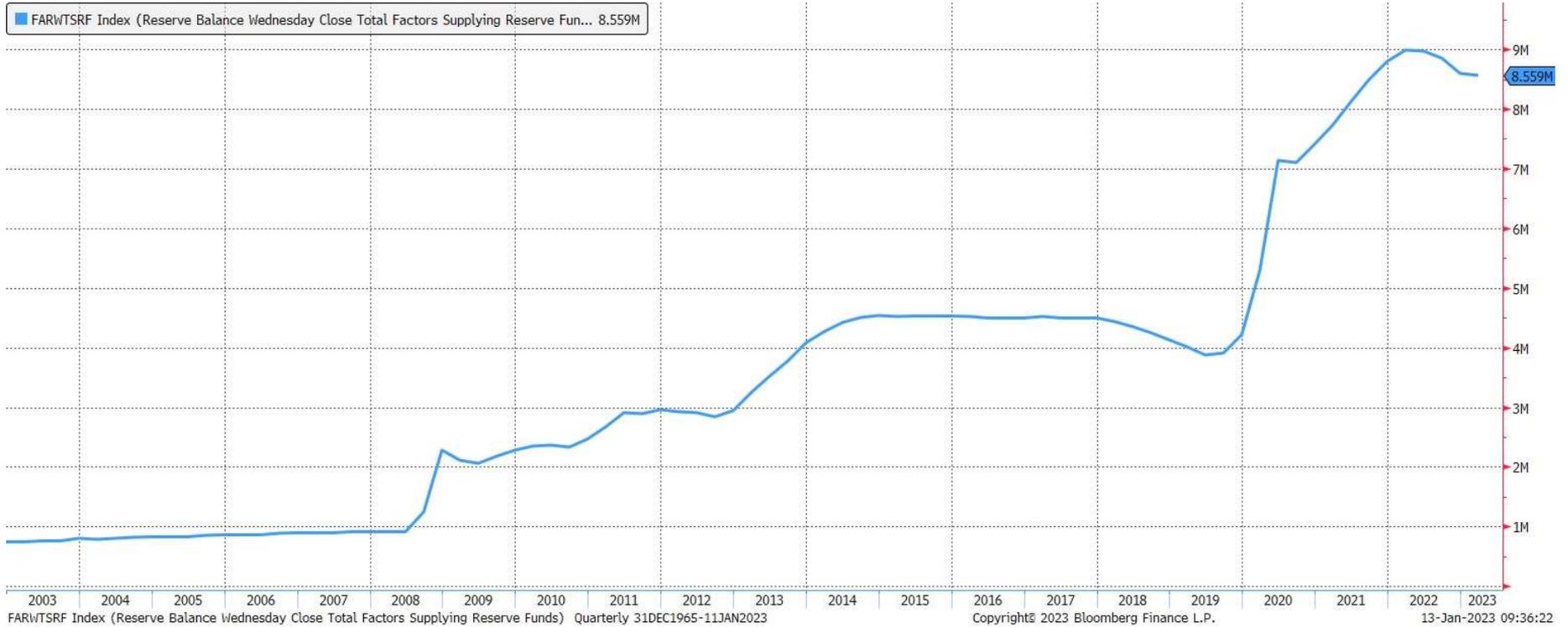
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Fed balance sheet

FARWTSRF Index (Reserve Balance Wednesday Close Total Factors Supplying Reserve Funds)

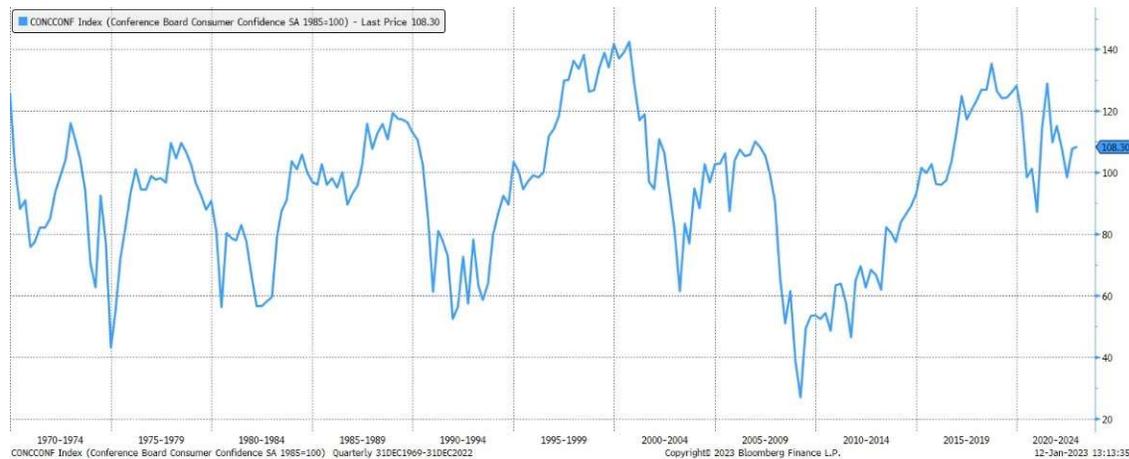
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Consumer confidence: holding up for now

CONCCONF Index (Conference Board Consumer Confidence SA 1985 = 100)

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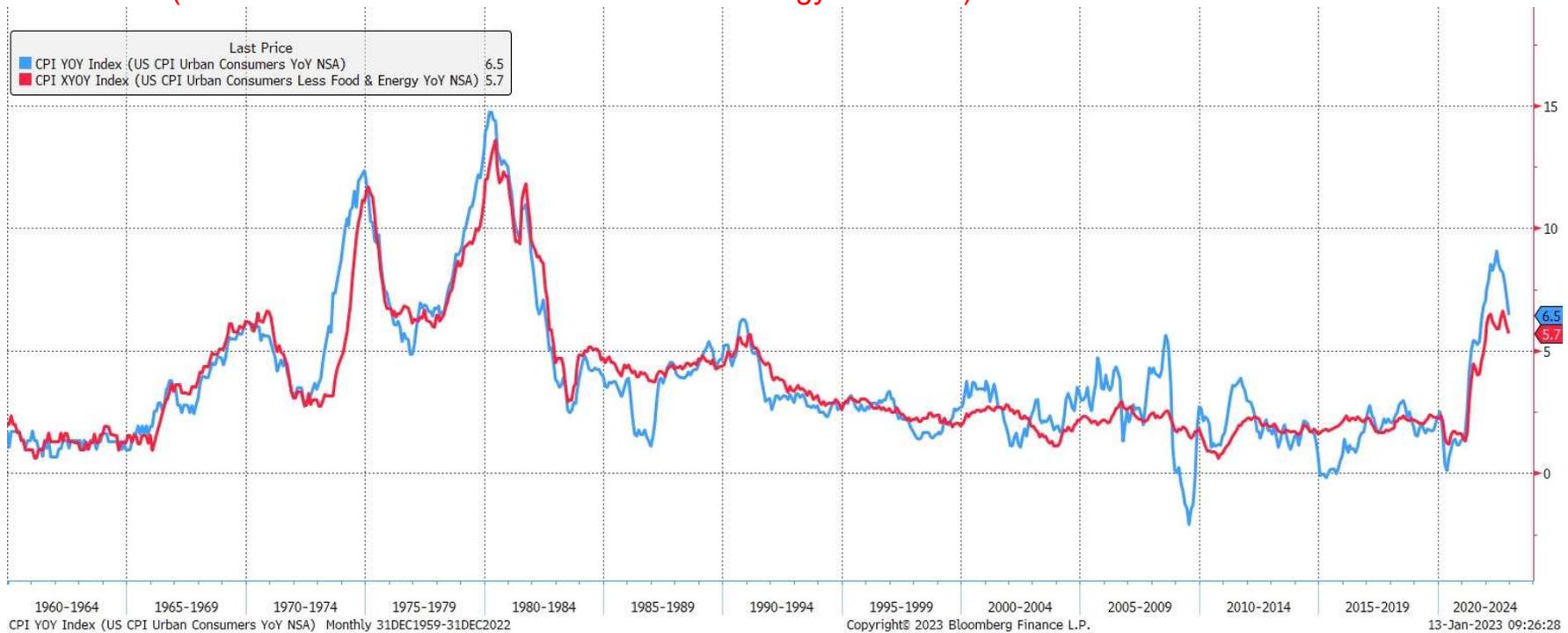


CPI inflation surprised on the upside

CPI YOY Index (US CPI Urban Consumers YoY NSA)

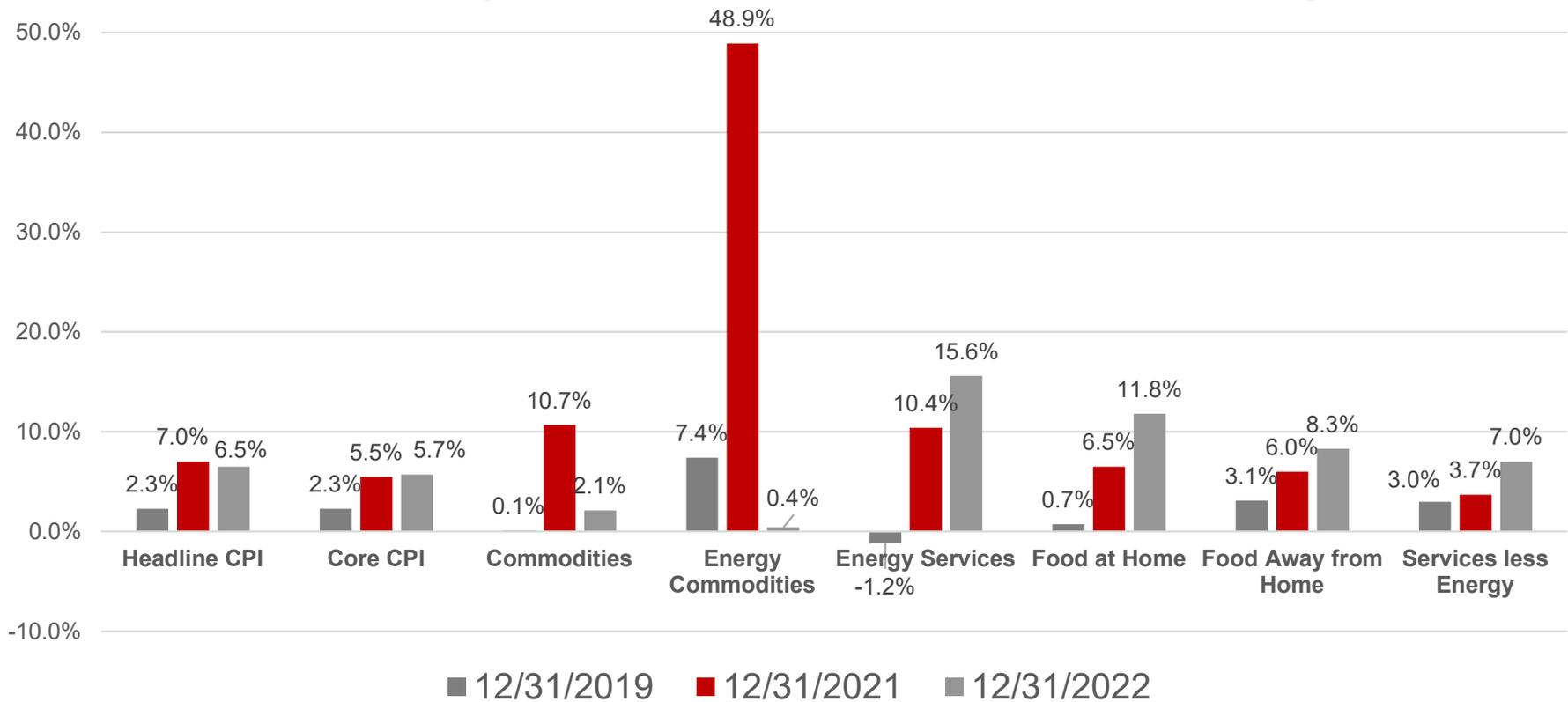
CPI XYOY Index (US CPI Urban Consumers Less Food & Energy YoY NSA)

Bloomberg



CPI dispersion/contributions

12-Mo. Change in US Consumer Price Index for Period Ending

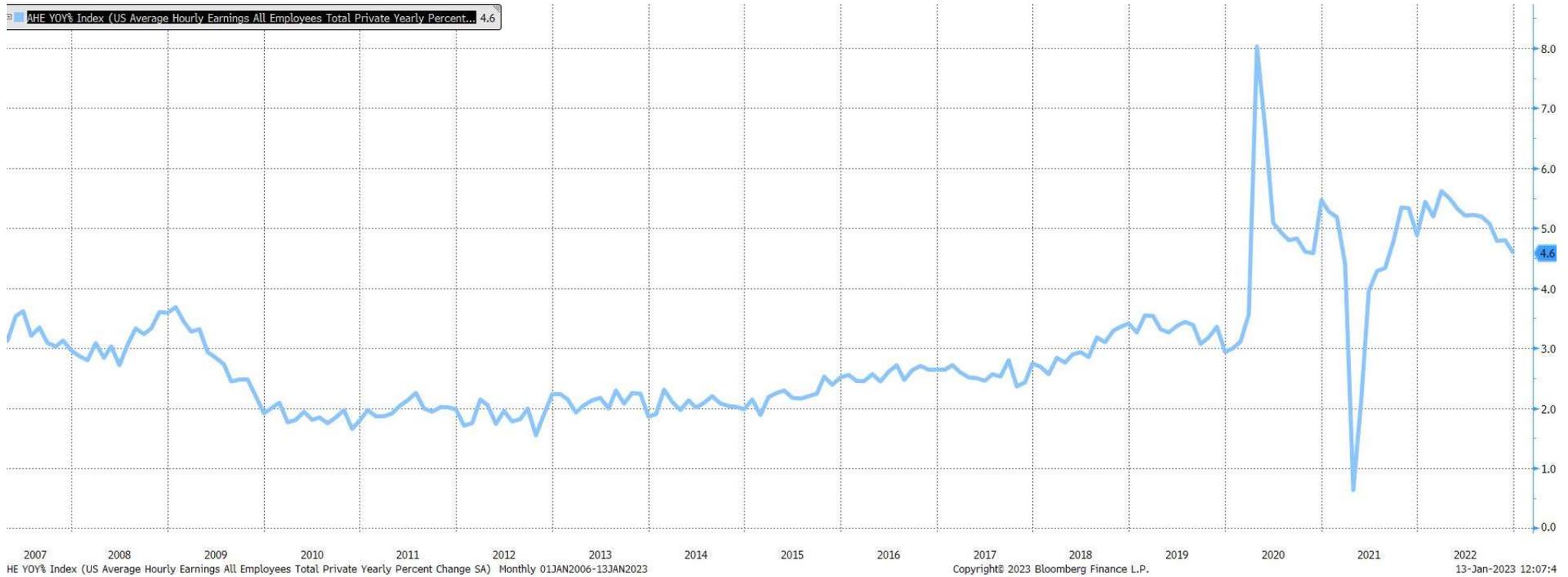


Contain inflation and maintain growth?

- The factors driving inflation are now mainly embedded in wage growth and labor supply.
- Extending flexibility in work from home may take some pressure off wages.
- The faster supply recovers, the less draconian the Fed needs to be in restricting demand.
- The race between supply recovery and inflation momentum will determine if we have a recession.

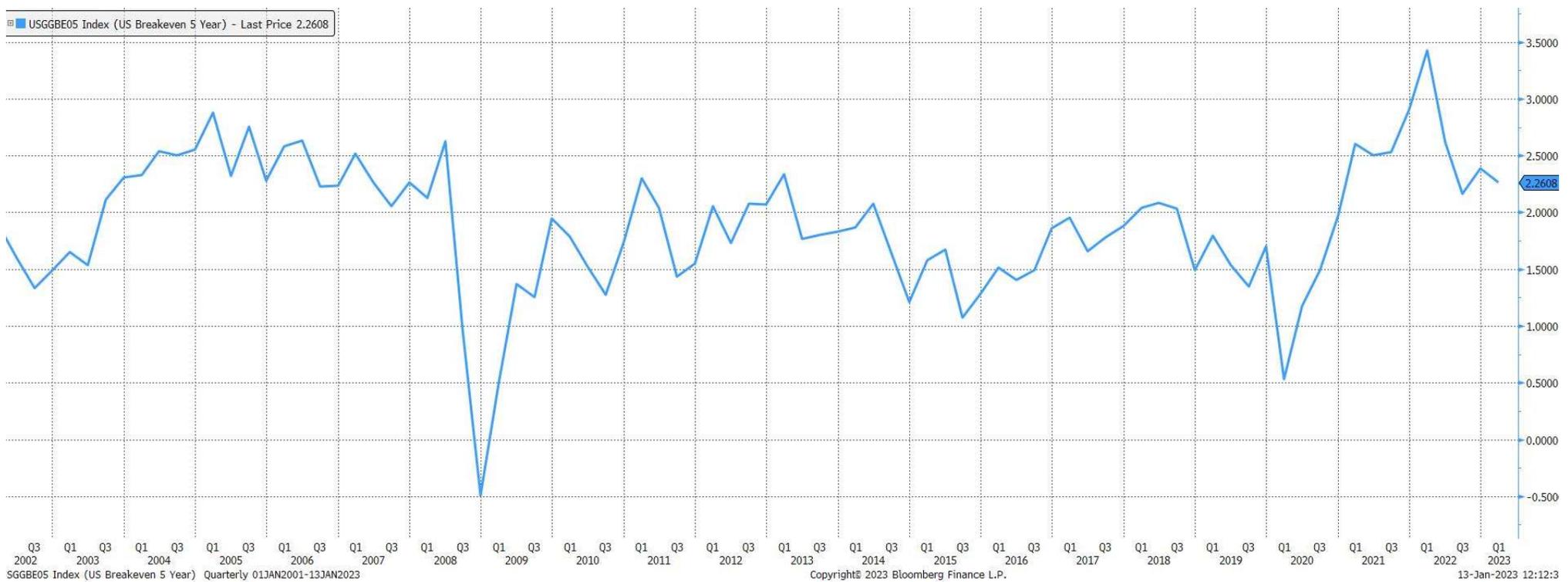
Change in average hourly earnings

AHE YOY% Index (US Average Hourly Earnings All Employees Total Private Yearly Percent Change SA)



TIPS five year breakeven inflation rate

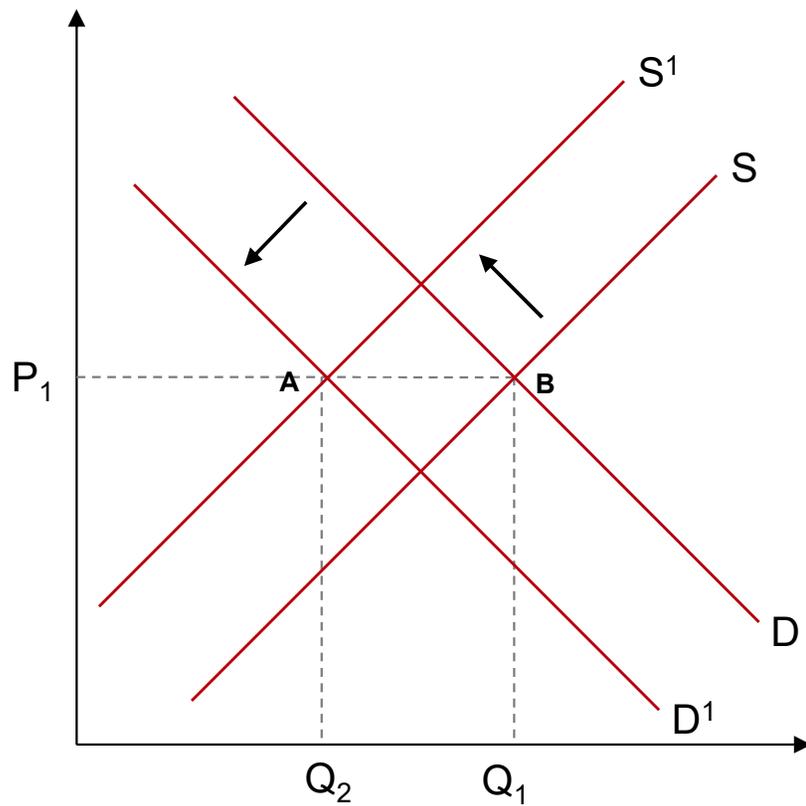
USGGBE05 Index (UW Breakeven 5yr)



A framework for understanding pandonomics

- The pandemic shocked aggregate D and S:
 - D drops due to lockdowns and reduced wages.
 - S drops due to limits on work.
 - These shifts depress output.
- Fiscal and monetary policy shift demand back out, which helps restore output but with inflation.
- Vaccines enable near full opening, but labor supply has not yet fully recovered.

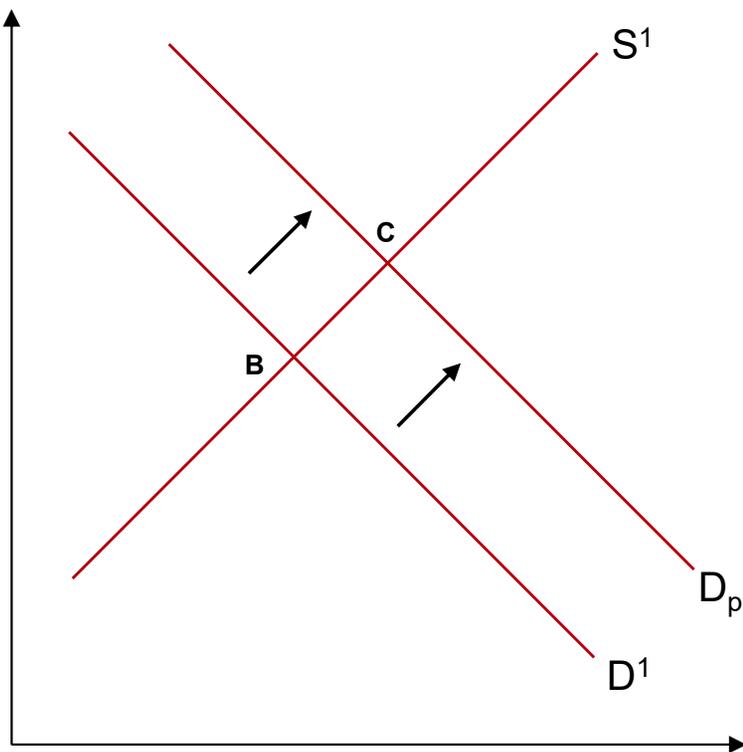
A framework for understanding pandonomics



April 2020

- The Pandemic initially caused a sharp decline in production and output without inflation.

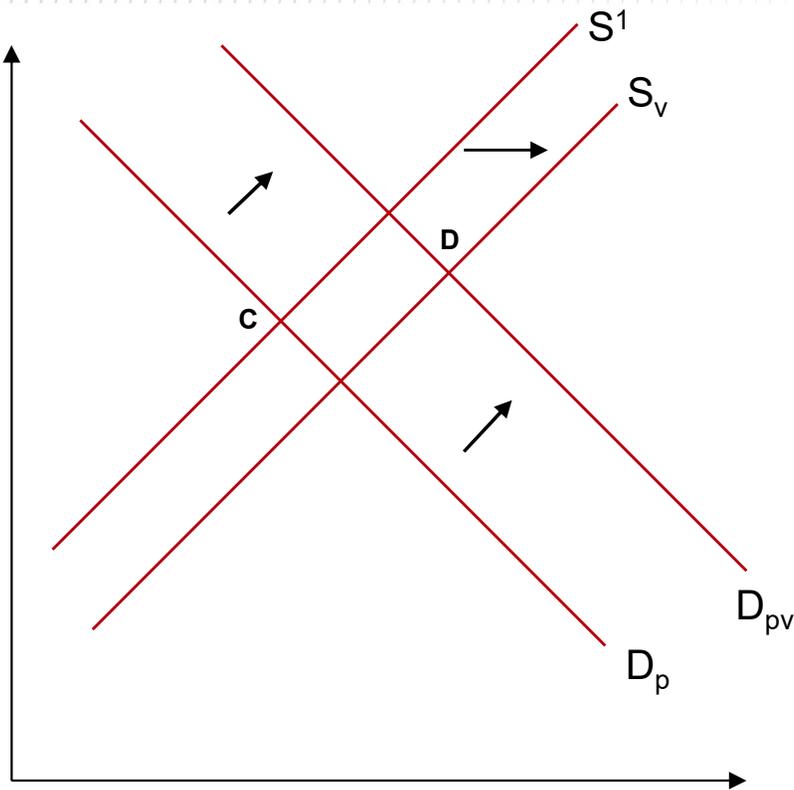
A framework for understanding pandonomics



Ca. August 2020-Summer 2021

- Fiscal and monetary policies boost demand but supply remains compromised, especially in travel, leisure, hospitality.
- Output rises, but so does inflation.

A framework for understanding pandonomics



Fall 2021 through 2022

- Vaccines enable the full range of demand with reopening of travel and hospitality. They also help bring more workers back.
- Inflationary pressures mounted, as excess savings boost demand and many workers are still “missing.”

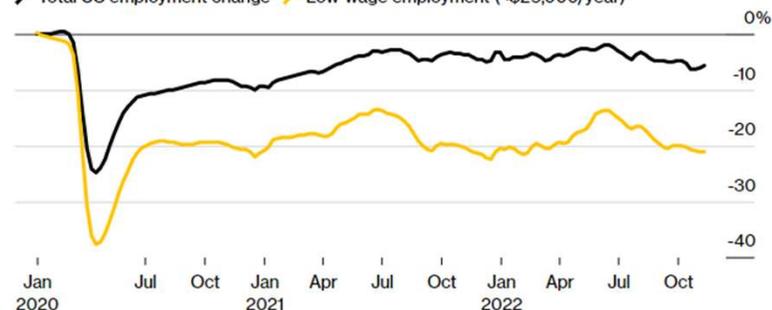
Labor supply slow to recover

- I predicted COVID would fade and the labor market would normalize by summer 2022.
- Wrong: low-wage workers still missing!
- Harvard economist Raj Chetty finds workers missing in high density, high-income markets.
- Labor supply is 2.6 million lower than pre-pandemic participation rates would imply.

The Shrinking Low-Wage Workforce

Estimated change in employment compared to January 2020

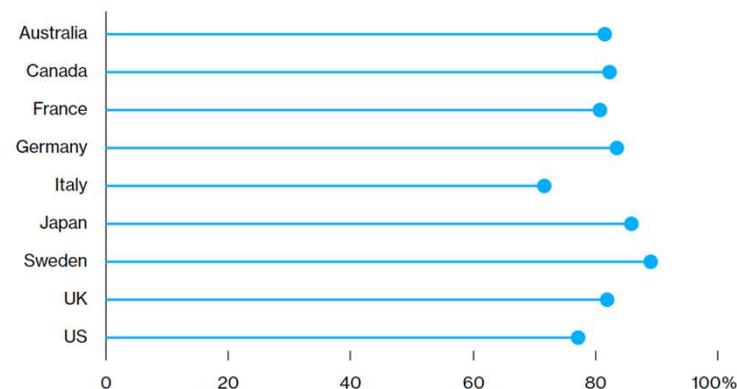
▲ Total US employment change ▲ Low-wage employment (<\$29,000/year)



Source: Opportunity Insights Economic Tracker, using data from Earnin, Intuit, Kronos and Paychex

US Lags in Share of Prime-Age Adults in Workforce

Labor force participation rate for 25-64 year olds, by country



Source: OECD 2022 Employment Outlook based on 2021 data

My outlook for 2023

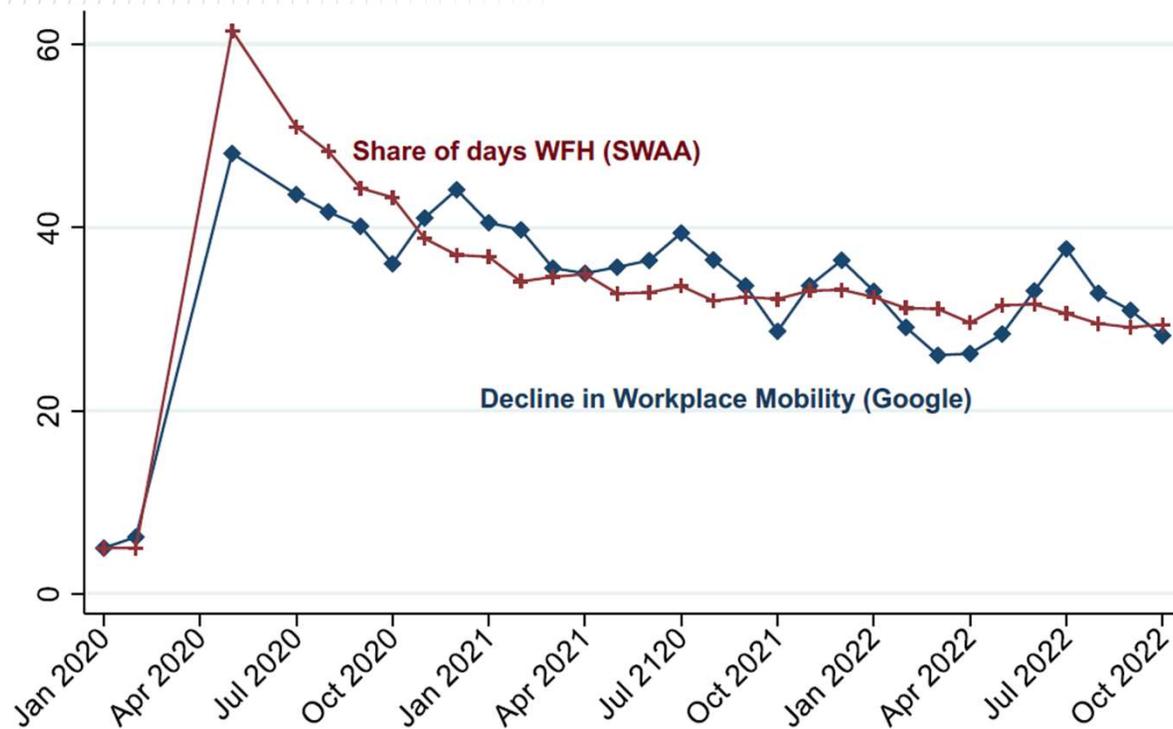
- The possibility of a soft landing depends on recovery of U.S. labor supply and China's manufacturing.
- The odds of a technical recession seem 50/50 but growth is going to be lower for longer as we adjust to deglobalization and decarbonization.
 - 1% GDP growth for 2023
 - Unemployment remains below 5%
 - Core inflation of 3% y/y in December 2023
 - S&P finishes 2023 at 4400

Remote work has legs!



- All else equal, value of WFH to employees is estimated to be about 10% of pay.
- Last year: “The market will find the value of WFH in new normal.”
CORRECT!
- WFH functionality exemplifies the importance of our technological innovation and leadership.
- We won’t know the impact on culture for a while, but I expect it will be positive. More focus on deliverables.

Indicators of % Increase in WFH



Source: Survey of Working Arrangements and Attitudes (SWAA), Jan. 2023

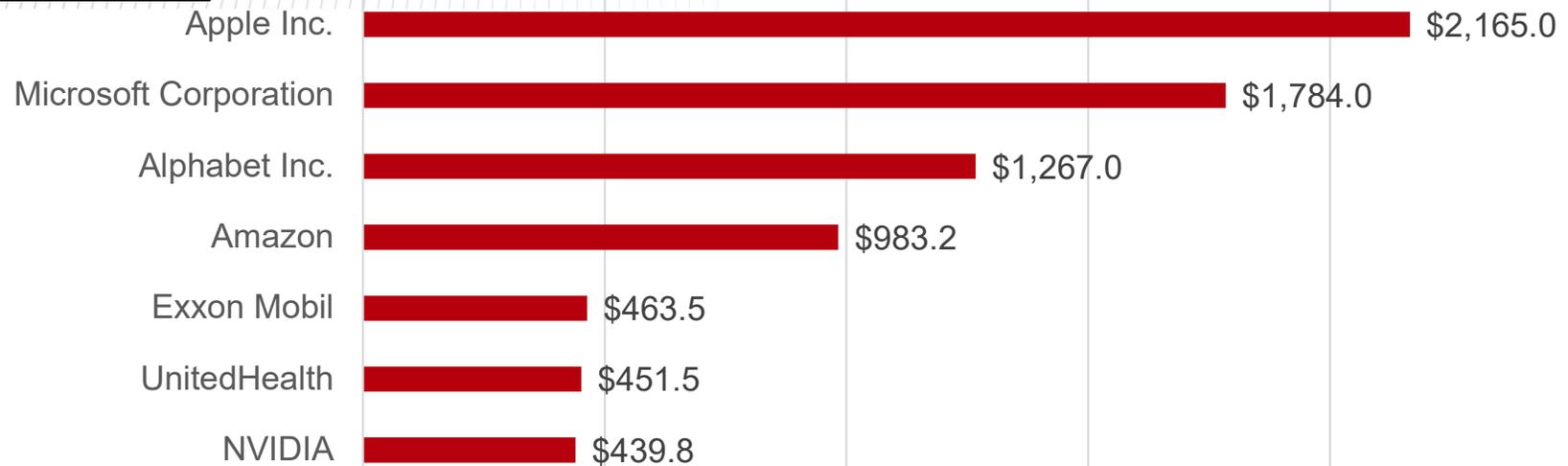
U.S. Economic Dynamism: alive and well

- Creative destruction of capitalism continues to push our economy forward.
- AI, robotics, and virtual reality may usher in a 4th industrial revolution around the world.
- The U.S. is positioned to lead this revolution due to **broad and deep capital markets, rule of law, entrepreneurial culture, management talent, and dominance in higher education.**
- These conditions have remade the landscape already: ChatGPT



10 largest U.S. companies by market cap

Founded after 1975



Founded before 1975



\$ Billions

0

500

1000

1500

2000

2500

Open Artificial Intelligence (AI)

ChatGPT is at capacity right now

[Get notified when we're back](#)

Write a standup comedy routine about the status of ChatGPT.

Comedian: "So I was trying to use this new AI chatbot website called ChatGPT and I got an error message that said 'A lot of people are checking out ChatGPT right now. Please check back soon!'"

(pauses for laughter)

Comedian: "I mean, seriously? The website is so popular that it can't handle all the traffic? And my only option is to 'check back soon'? It's like they're saying 'Sorry, we're too popular right now. Try again later.'"

The New York Times

Microsoft to Invest \$10 Billion in OpenAI, the Creator of ChatGPT

The tech giant aims to remain at the forefront of generative artificial intelligence with its partnership with OpenAI.



ChatGPT's reasons to live in Wisconsin...

- Quality of Life: stunning rolling countryside...abundant outdoor recreational activities...also has a vibrant culture of art and music.
- Affordable cost of living
- Education: Wisconsin has some of the best public and private universities in the nation, as well as highly rated public school districts.
- Jobs: Wisconsin has a diverse and healthy economy.
- Easy Access to major cities.

ChatGPT's 2023 outlook...

- 2023 looks to be a positive year for the U.S. economy...
- Economic growth is expected to remain modest, but real GDP is forecasted to expand at roughly a 2% rate...
- The labor market is expected to remain strong, with the unemployment rate expected to stay below 4%...
- Inflation is expected to remain low, and will likely remain contained due to continuing productivity gains and a low level of government spending
- Interest rates are expected to stay steady, even with any potential future Fed rate hikes.
- Lastly, the stock market should remain positive and maintain its current record high levels.

Longer-term challenges and opportunities

- Challenges
 - Authoritarianism v Democracy
 - Federal debt and \$ dominance
 - Political turmoil
 - Carbon transition
- Opportunities
 - Greater cohesion in EU and the Americas?
 - Technological leadership
 - Sane immigration policy