
Economic Outlook for U.S., and Illinois in 2012

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* The views expressed herein are my own and do not necessarily represent those of the Federal Reserve Bank of Chicago or the Federal Reserve System.

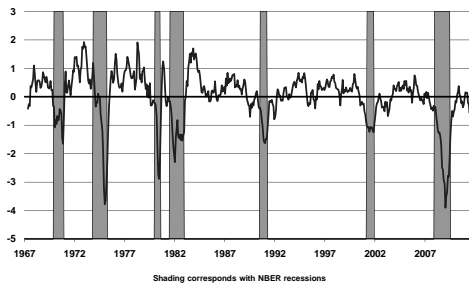
Presentation Road Map

- **Understanding The Great Recession**
- **What is the recovery looking like?**
 - What is lagging?
 - Any good news?
 - Will the economy reach "escape velocity" in 2012?
- **What about Illinois/Chicago?**

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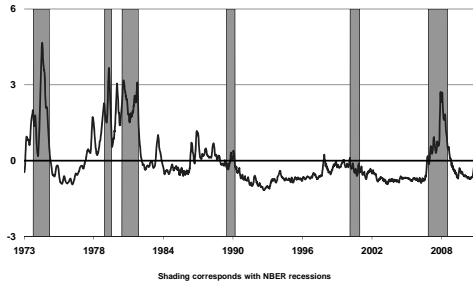
Economic Activity

Chicago Fed National Activity Index
(standard deviation from trend, 3-month average)



Financial Conditions

Financial Conditions Index
(deviation from trend, 100-variable index)



GDP growth has been disappointing

- Q1 was revised down to 0.4% (originally 1.8%)
- Q2 didn't show much of a rebound...1.3%
- Revisions also showed that recession was far worse than originally thought
- (some impact from special factors, Japan, supply chain disruption, Greece, oil prices)
- NABE GDP forecast has been cut to 1.7% vs 2.8% (May) for 2011 and 2.3% vs 3.2% (May) for 2012
- FOMC forecast in November was cut from 2.8% to 1.7% (2011), 3.5% to 2.7% (2012) and 3.9% to 3.3% (2013)
- Certainly not the usual pattern

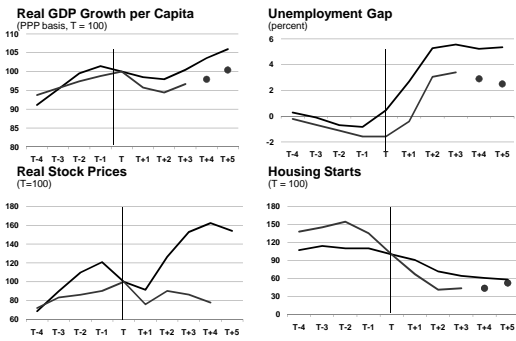
Why was this recession so different?

- One word—"leverage"
- Why will the recovery be so different?
 - One hyphenated word—de-leverage
- Big issue—repricing risk
- The New Normal

All adds up to a slower climb out

- Financial recessions are different (Rogoff/Reinhart)
- Still lots of slack in labor and housing and soft demand
- Everyone is still repairing their balance sheet

Banking Crises' Deep and Long-Lasting Effects



"Big 4" Crises (Norway 1987, Finland 1991, Sweden 1991, Japan 1992)
US 2007

The big hangover—employment, housing and the government sector

- A jobless recovery—when will hiring pick up?
- Housing—still working through foreclosures, inventory is too high and lack of demand even with record low mortgage rates
- Government sector is out of money and debt is piling up

Employment is the number 1 concern

- Nearly 50% are “long-term” unemployed (more than 6 months)
 - Skills atrophy
 - Wages are not recovered
 - Need for retraining
- Lack of labor recovery undermines consumer confidence
- Need consistent monthly gains of 200K to make a dent in unemployment. Last six months gains have averaged around 135K. January report had 200K growth in December however more than 40K were in delivery services
- FOMC forecast has unemployment at 9.1% (2011), 8.6% (12/2012) and 8.0% (12/2013)

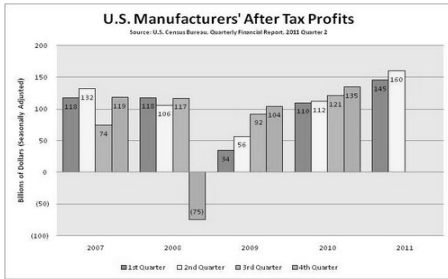
Housing

- Prices are bumping along the bottom
- Still too many foreclosures
- A couple of markets are stable/recovering, but
- Homeowner finances are tenuous
 - CoreLogic estimates (Q3 2011) states with negative equity
 - Arizona 47.1%
 - Florida 43.9%
 - Nevada 58.3%
 - California 29.7%
 - U.S. 22.1%
 - Illinois 21.5%
- Little bounce back in construction, new home sales are on track to be the lowest since they began recording them in 1963. (on pace for less than 500,000, were over 1 million in 2005)

Any good news?

- We are saving again (or at least shedding debt)
- Large banks have recapitalized, but lending activity appears constrained
- Inflation appears contained? Since September CPI and core have seen either declines or minimal growth
- Consumer is coming back—sort of. Christmas season was okay, expectation for retail sales in 2012 is for gains of 3.7% (below 2012 levels)
- Manufacturing, Agriculture have been doing well—Midwest is actually doing better than South or West
- Large firm profits have been strong—but not necessarily from orders—small firms are another story

Manufacturing Bounce Back

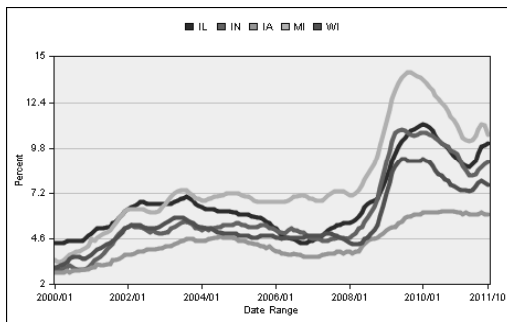


Turning to Illinois and Chicago metro

- **Common theme—performance both in the recession and in recovery has been bumpy, however November Midwest Economic Index had Illinois making the largest positive contribution to regional performance**
- **Evidence on why is mixed—manufacturing rebound should help, performance of business and professional services, finance seems to be a key. Lots of starts and stops (example-- Hotel sales were big first half of 2011 then flamed out)**
- **An issue is uncertainty, particularly in public finance. Structural deficits and significant pension problems mean tax hikes, service reductions or both. Moody's has Illinois rated A2...tied for worst in the nation.**
- **Both have significant assets but can they be leveraged?**
- **Turning to Illinois first...**

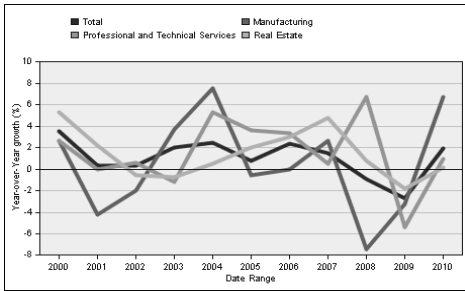
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Illinois—unemployment rate is worse than you would think



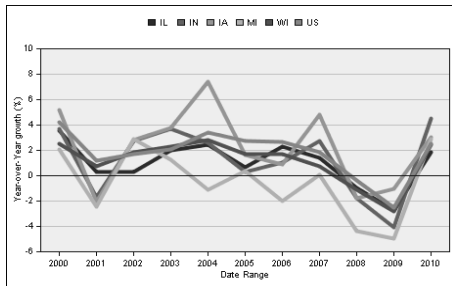
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Key industry rebound has been uneven



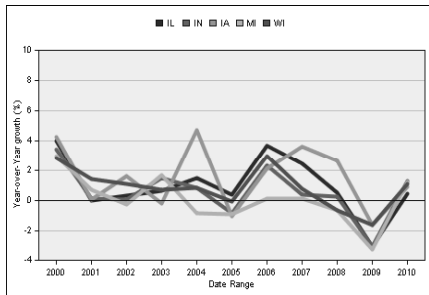
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So has output...



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And housing...



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Turning to Chicago

- **City finances are a big question, while currently stabilized problems still loom**
 - tax revenues are soft
 - impact of declining property values are still working way through the system.
 - Running out of things to sell...parking meters and Midway Airport
- **Recovery by key sectors has been uneven. Finance in particular disappoints. Real Estate still has surplus in condos and commercial real estate space.**
- **What is Chicago's image? Reason for concern?**
- **The conundrum concerning Chicago's economic performance-are we still the capital of the Midwest?**
- **Good news still a talent magnet**

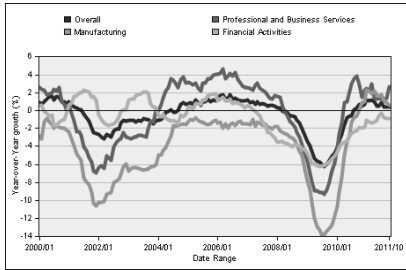
Chicago Employment Performance...uneven

Sector	Sept 2011	Sept 2010	Oct 2009	Change '10/'09
Construction	165.2	158.0	170.5	-5.3 (-3.1%)
Manufacturing	407.5	405.0	406.9	0.6 (0.1%)
Wholesale trade	238.0	229.1	226.9	11.1 (4.9%)
Retail Trade	431.5	432.3	440.0	-8.5 (-1.9%)
Total private sector	3738.1	3714.3	3701.6	36.5 (1.0%)

Chicago Employment Performance

Sector	Sept 2011	Sept 2010	Oct 2009	Change '11/'09
Information	74.9	79.3	81.5	-6.6 (-8.1%)
Financial activities	283.5	286.4	291.8	-8.3 (-2.8%)
Professional and Business Services	702.2	695.9	668.6	33.6 (-5.0%)
Education and Health	640.6	637.2	632.1	8.5 (1.3%)
Leisure and Hospitality	406.4	405.5	396.6	9.8 (2.5%)

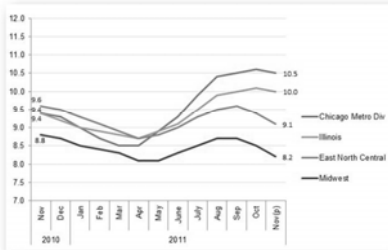
Driven by key industries



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Unemployment performance lags

- Not what we would prefer....



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Enough about the data...what do studies say about Chicago's performance

- As you will see our position, performance and reputation is crystal clear...

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A quick review...

- Sporting News 2011—Best Sports Cities, Chicago is 4th. Only better cities are Dallas, Boston, Philly. Rank ahead of NY, Pittsburgh, Atlanta, LA. (last #271 is Lorman, Miss.)
- Men's Health 2011—The 100 Best (& Worst) Cities for Men, not so good news—#73 (Milwaukee is #72 and Indianapolis is #74). Last is Little Rock, Arkansas. Ranking is based on 37 criteria mostly health and quality of life related
- Men's Health 2011—Top 100 Social Networked Cities...we aren't— #39 a grade of C+. Puts us in a league with such social hotspots as Des Moines, Jersey City, Fargo and Cleveland. However at least we aren't El Paso which gets an F. (Based on LinkedIn, Facebook users per capita plus Twitter usage)

More studies...

- American Institute for Economic Research 2010-11 College Destinations Index—Out of 15 major metros Chicago was #11 (criteria included student concentration and diversity, quality of life and professional opportunity)
- Knight Frank Global Cities Survey (Citi Private Bank) Top 25 Global Cities of 2011. #11 (now were talking). Ahead of D.C., San Francisco, Hong Kong, Sydney, Frankfurt. Number 1 was NY, then London, Paris. Criteria were Economic Activity, Political Power, Quality of Life, Knowledge and Influence. Chicago only placed in the top 10 (#6) in Knowledge and Influence (number and ranking of educational institutions, number of news media organizations and share of international media market)
- BusinessWeek 2011 Inaugural Best US city ranking...#75 out of 100. Not so good but the winner was Raleigh, NC so maybe we don't care.

And even more...

- Back to Good News—Globalization and World Cities Research Network GaWc 2010 ranked Chicago as an Alpha + global city. This puts us in the company of Hong Kong, Paris, Singapore, Tokyo, Shanghai, Dubai and Sydney. Only NY and London are Alpha+++ cities.
- But what about quality of living...Mercer 2011 survey...out of the top 50 cities worldwide we are #43. Tied with Madrid and Washington, DC.
- Are we happy? Apparently not...Chicago is the 7th most Miserable City according to Forbes in 2011. Why? long commutes, high sales tax, weather, crime, foreclosures and home price trends
- How about Job growth? Newgeography.com 2011 Best Cities for Job Growth, Chicago is #41 out of 65.

And more yet...

- But perhaps we are innovative...not bad--Innovation Cities Americas Index 2011 has Chicago at #9 and #34 Globally. We are just below the top tier classification

To summarize

- We are a global and innovative city that is generally miserable, particularly for men and college students, is slow to add jobs and isn't very socially networked but has a good sports culture.

A Final Word—the big problem
Illinois Fiscal Landscape

- State had a structural deficit prior to the recession
- Pension and OPEB liabilities loom large—state pension funds are only about 40 to 45% funded
- Reluctance to fix the problem—little consideration of either tax reform or expenditure restructuring
- New tax increase will help with the operating deficit but not enough to deal with longer term problems
- Municipalities face major pressure. Lack of real estate recovery hurt property tax collections while state and Federal money gets cut
- Only good news in issuing debt is really cheap. (On December 30, AAA muni's were 1.78% down from 3.08% same time last year

Summary

- US performance still faces headwinds. Deleveraging, risks in world economy (Europe meltdown, China/Asia slowdown). Growth but not particularly exciting
- Illinois and Chicago are still performing below the US average when the average isn't all that impressive
- Big uncertainty is still the fiscal picture. Neither municipalities nor state are in good shape. Major reform is needed, not tinkering.
