Overall Georgia and U.S. Economic Outlook

by **Jeffrey M. Humphreys**, Director of the Selig Center for Economic Growth
Terry College of Business, University of Georgia

Key Takeaways

- In 2023, the postpandemic expansion ends, and a mild recession begins.
- The 2023 recession will be mild and short.
- Tight monetary policy because of high inflation is the main reason to expect a recession. Energy price shocks are a second reason to expect a recession.
- Georgia's economy will do better than the U.S. economy.
- Economic development projects will provide a solid push to Georgia's economy.

2023 Forecast

My main prediction for 2023 is that the postpandemic expansion ends and a mild recession begins. I expect the 2023 recession to last about 6 months, which is short. On average, the length of post-WWII recessions is 10 months. A 2023 recession is not inevitable, but it would take near-perfect monetary policy plus a lucky break to avoid one. I put the probability of recession at 75%. It will be extremely difficult for the Federal Reserve to cool down the economy enough to contain the highest inflation in 40 years without triggering a recession. Although I expect both the United States and Georgia economies will be in recession, Georgia's economy is better positioned to weather a recession than the U.S. economy.

My forecast calls for Georgia's inflation-adjusted gross domestic product to decrease by 0.2%, which is smaller than the 0.7% drop I expect for U.S. GDP. What will subtract from or add to 2023 GDP growth? I expect less spending on structures to subtract the most from GDP growth. Housing is the "canary in the coal mine" when it comes to recessions caused by Federal Reserve policy moves. Housing is the most interest-sensitive sector of our economy. Similarly, higher interest rates will cause businesses to spend less on nonresidential structures. Higher interest rates and lower profits mean decreased spending by businesses for equipment, which will subtract from GDP growth. Inventory changes will subtract slightly from GDP growth. Spending by consumers will neither add to nor subtract very much from GDP growth, which is good because consumers account for about 70% of GDP. That stability is one reason I expect the 2023 recession to be mild. Government spending will add to GDP growth, especially spending by state and local governments. Higher spending on intellectual property and software will add to GDP growth. Put it all together, and Georgia's GDP for the year is approximately flat. That is not good, but it is far better than our experience in recent recessions. For example, Georgia's GDP declined by 4% in 2020. In the Great Recession, Georgia experienced back-to-back years of negative GDP growth—GDP declined by 2% in 2007 and by 4% in 2008.

I do not expect Georgia's labor market to get hit very hard by the 2023 recession. On an annual average basis, the number of jobs will rise by 0.1%, which is better than the 0.5% decline we expect for the United States. The small positive gain reflects job growth early and late in the year that offsets midyear job losses. One reason I do not expect many job losses is that employers will be slow to lay off workers. Employers went to great lengths to hire enough workers in the wake of the pandemic and know that workers will be in short supply on the other side of the recession. In addition, many of the economic development projects that Georgia landed over 2020–2022 will be completed in 2023, which will offset jobs losses in other industries.

Most job losses will be in the most interest-sensitive sectors of the economy such as construction, financial activities, mining, and logging. Some industries will continue to add jobs, including health care, education, leisure and hospitality, professional and business services, transportation, manufacturing, and government. Many job openings posted in 2022 were not filled in 2022 and will carry over into 2023. Deferred hiring will help ensure that the recession is mild.

In 2023, I expect the unemployment rate to rise, but not too much. Georgia's unemployment rate will average 3.8% in 2023 compared to 3.3% in 2022. Georgia's unemployment rate will remain well below the U.S. unemployment rate of 4.4%, which means the Fed is likely to stop tightening monetary policy before labor market conditions get bad in Georgia.

Georgia Baseline Forecast, 2022–2023

	2018	2019	2020	2021	2022	2023
Gross domestic product (billions, 2012 USD)	539.3	558.3	536.7	567.9	581.0	579.8
Percent change in GDP	2.7	3.5	-3.9	5.8	2.3	-0.2
Nonfarm employment (thousands)	4,535.7	4,619.9	4,409.0	4,570.2	4,779.3	4,785.7
Percent change in nonfarm employment	1.9	1.9	-4.9	3.7	4.6	0.1
Personal income (billions, USD)	493.2	518.3	554.6	597.1	618.0	642.7
Percent change in personal income	5.1	5.1	7.0	7.7	3.5	4.0
Housing permits (total)	59,315	53,823	53,131	65,167	64,230	53,586
Percent change in	15.8	-9.3	-1.3	22.7	-1.4	-16.6

housing permits						
Unemployment rate (percent)	4.0	3.6	6.5	3.9	3.3	3.8
Source: The Selig Center for Economic Growth, University of Georgia Terry College of Business, November 7, 2022.						

In many ways the economies of both the United States and Georgia are fundamentally sound. Why then, do I expect a recession? There are three reasons: tight money due to extremely high inflation; massive energy price shocks; and negative wealth effects because of declines in asset prices. The Fed's rapid shift from an extremely stimulative monetary policy to a very restrictive policy is the main reason I expect a recession. The Fed said it will do whatever it takes to tame inflation. If you hit the economy over the head enough times with massive rate hikes, eventually it falls.

For many people, the doubling of mortgage interest rates in the first half of 2022 was the first tangible evidence of the Fed's rapid shift from easy money to tight money. Higher mortgage rates combined with the recent sharp run-up in home prices reduced housing affordability, which pushed Georgia's housing industry into recession.

In the second half of 2022, policy interest rates moved firmly into restrictive territory and began to affect the economy more broadly. But the strong labor market prevented a recession from developing in 2022. Georgia's unemployment rate hit lows rarely experienced in the last half century. People knew they could find a job, and at a higher salary than the job they currently had. That is why the employee quit rate was high even as talk about a potential recession escalated. The strong labor market encouraged people to save less and spend more. The savings rate fell from about 8% in fall 2021 to less than 4% in fall 2022. As inflation roared, people took on more credit card debt to sustain their spending habits.

I believe that the Fed will need to raise the federal funds rate to between 4.75% and 5.00% to short circuit the inflationary wage-price spiral that began to gain traction in 2022. I expect the Fed to keep rates at that level until inflation slows to about 3%, sometime in the third quarter of 2023. At that point it will be clear that the economy is in recession. The U.S. unemployment rate will have risen above the full-employment unemployment rate of 4%. Mindful of its dual mandate is to ensure stable prices and maximum (full) employment the Fed will make its first rate cut. Shortly thereafter, Georgia's economic downturn ends, and a new economic upturn begins.

The energy price shock that we experienced in the wake of Russia's invasion of Ukraine is the second reason I expect a recession. Large energy-price shocks caused by supply reductions rather than robust demand growth almost always trigger or worsen recessions. There is no upside to high energy prices for Georgia. Our long commutes and heavy focus on transportation and distribution make Georgia more vulnerable than most states to oil-price spikes. The negative wealth effects of declines in stock, bond, and home prices are another reason we expect a recession. While declines in asset prices rarely trigger recessions, they worsen recessions triggered by other factors. Moody's Analytics estimates that, on average, through the business cycle a $1 decline in stock market wealth leads consumers to reduce spending by 2.5 cents in the following year. Moody's Analytics believes the wealth effect will be smaller in 2023 because the recent decline in stock prices simply puts many investors back to where they were in early 2021. I believe that is correct. Most shareholders never thought they were as wealthy as the value of their holdings indicated at the beginning of 2022. In 2023, these negative developments will feed off each other and in combination will end the expansion that began in mid-2020. The 2023 recession will be mild and short. Mild, because the labor market is strong, household balance sheets are in decent shape, and households are still sitting on unanticipated savings accumulated during the pandemic. In addition, several large economic sectors (e.g., health care, education, hospitality, and state and local government) will still be rebounding from the pandemic. It will be easy for those industries to post year-over-year gains. The recession will be short because the Fed will be mindful of its dual mandate. I believe the Fed will not tolerate the degree of economic damage that would result from raising policy interest rates high enough to achieve its explicit inflation target of 2%. I believe the Fed will settle for 3% inflation. If I am correct, the 2023 recession will only last two quarters. Should the Fed insist on 2% inflation, then recession will be longer and more severe. There are state-specific forces that will help Georgia’s economy better weather the 2023 recession than the U.S. economy. One main advantage is the enormous number of projects in Georgia’s economic development pipeline. In fiscal year 2022, Georgia posted another record year in economic development. There were 358 projects, more than 51,000 jobs, and over $21 billion in investments. Foreign direct investment was especially strong.

Another factor behind the expectation that Georgia’s economy will do better than the U.S. economy is that Georgia will get more leverage than most states from higher new vehicle sales. I expect U.S. auto sales to increase by about 15% in 2023, which is an unusual forecast for a recession year. Typically, auto sales tank during recessions, especially when the recession is triggered by higher interest rates. The explanation is simple. Many folks that wanted to buy a new car could not do so because not enough cars were available. New car dealers had a strong advantage over buyers, especially for popular models. Not surprisingly, many people kept their current cars longer than they would if market conditions were normal. The average age of cars on the road rose to a record 12.2 years. Many cars on the road are at the end of their economically useful lives. They need to be replaced. In 2023, more new cars will be available for purchase. Pent-up demand will be unleashed. Sales of new vehicles will soar.

The nation’s automobile manufacturing industry is becoming increasingly concentrated in the Southeast. Georgia has had immense success growing the electric mobility industry. For example, Hyundai Motor Group will invest $3.5 billion to build its first dedicated electric vehicle manufacturing plant near Savannah, creating 8,100 jobs. The Hyundai project is the largest economic development project in Georgia’s history.

Georgia’s outsized transportation, distribution, and logistics industry will continue to grow much faster than that of the nation. Of course, activity in transportation and distribution is cyclical.Growth will certainly slow, but growth will not stop. That is highly unusual for a recession. Cargo volumes will grow as major transportation and distribution projects announced over the past 2 years will build out and become operational in 2023. A second reason for our optimism is that recent capacity additions will enable Georgia’s transportation and logistics providers to take market shares from providers in other states. For example, a second inland container port will open near Gainesville. In addition, the Mason Mega Rail Terminal at the Port of Savannah is providing more frequent and faster rail services to Midwestern cities like Memphis, St. Louis, and Chicago, as well as cities in the Ohio Valley. The build-out of recent economic development projects involving the relocation and expansion of manufacturers also bolsters prospects for Georgia’s transportation and logistics providers.

Another reason Georgia will outdo the nation is that our population will grow at an annual pace that is more than double the national average. According to United Van Lines, the primary reason people move to Georgia is a job, followed by family connections, lifestyle choices, retirement, and a lower cost of living. Compared to most other states Georgia will continue to compare well on all those dimensions in 2023. Usually, net migration drops sharply during recessions, but we expect a very slight drop. That is because unemployment rates will increase quickly in states like California and New York that typically send large numbers of people to Georgia.

Home sales and homebuilding subtracted from GDP growth in 2022. Housing activity will decline even more sharply in 2023. High mortgage rates, the recent run-up in home prices, and low confidence in the economic situation will prolong and steepen the housing downturn that began in mid-2022. The National Association of Realtors estimates that single-family homes were 31% less affordable in mid-2022 than in mid-2021. Consequently, I expect Georgia's homebuilders to begin construction on substantially fewer new single-family homes in 2023 than in 2022.

As of mid-2022, Georgia's existing home prices were 46% higher than prior to the COVID-19 recession. Cumulative inflation over that period was only 14%. I expect existing home prices to drop by about 12% in 2023. In addition to decreased affordability, overvaluation is another reason home prices will drop.

Despite substantial overvaluation, the fundamental supports for home prices are better now than during the Great Recession. I do not expect a repeat of the housing bust. One difference is that during the postpandemic housing boom people were buying homes to live in or as long-term investments. Not many homes were flipped. Those dynamics will limit home price declines. In addition, supplies of homes are constrained by years of underbuilding. There's not much new product in the production pipeline. That is the opposite of the situation during the Great Recession when most markets were overbuilt and there were too many homes in the production pipeline.

In the wake of the 2023 recession, home prices will be 12% lower than in early 2022, but still well above prepandemic levels. Unless the home was purchased very recently, a 12% decline in home prices is a paper loss. Most homeowners never expected home prices to rise as much as they did in the wake of the pandemic. Most have not fully factored recent home price appreciation into their financial plans. For example, people did not borrow heavily against their new home equity gains to anywhere near the extent they did prior to the Great Recession. Plus, rents are soaring and will continue to do so, which will help support home prices.

Another significant difference between the postpandemic housing boom and the housing boom that preceded the Great Recession is that most new home mortgages are very well collateralized. I do not expect homeowners to default and walk away. I do not expect a wave, or even a mini wave, of bank failures. Housing is not the epicenter of this recession and does not pose a systemic risk to the economy.

On the other side of the 2023 recession, I believe there's good upside potential for the housing industry because of both solid demographics and the increased importance of the home as a place to work, to learn, and to play. In addition, there will be an immediate need to build new homes. In 2024, homes will be in short supply. The homebuilding industry may not lead the recovery of our economy, but it will support and contribute to it.

As always, there are risks to the baseline forecast. The main downside risk is that inflation is higher and more stubborn than expected which leads to even more restrictive monetary policy and larger asset price corrections. A second downside risk is additional, and potentially larger, energy-price shocks because of broader military conflicts, terrorist acts, natural disasters, or further worsening of relations with major OPEC producers. Another geopolitical risk is further deterioration of the relationship between the United States and China. For example, disagreements over Taiwan could disrupt shipping activity in the Taiwan Strait.

We need a lucky break. We are overdue. One upside possibility is that geopolitical conflicts ease quickly in positive ways. For example, a good, quick resolution of the war between Russia and Ukraine would bring down energy and other commodity prices, improve supply chains, and increase confidence. I am hopeful, but I am realistic and therefore do not base the forecast on that outcome. Another upside potential is that more economic stimulus is agreed upon after the midterms. Politically, that seems very unlikely, and might spook the bond markets. Just look at what happened in the United Kingdom shortly before Halloween. Another possibility is that the Fed threads the needle and executes monetary policy perfectly and achieves a “soft landing” for the economy. I am hopeful, and it is possible, but I do not believe that is the most likely outcome.

In closing, I expect the postpandemic expansion to end and a recession to begin. The recession is likely to be mild and short. The Fed’s move from easy to tight money will trigger the recession. Housing is already in recession and will suffer the most, but several large economic sectors will continue to expand. Our labor market will hold up well. The unemployment rate will not rise very much. I expect an economic recovery to begin late in 2023.

United States Baseline Forecast, 2022–2023						
	2018	2019	2020	2021	2022	2023
Gross domestic product (billions, 2012 USD)	18,606.8	19,032.7	18,384.7	19,427.3	19,738.1	19,600.0
Percent change in GDP	2.9	2.3	-3.4	5.7	1.6	-0.7
Nonfarm employment (millions)	148.9	150.9	142.2	146.1	151.2	150.5
Percent change in nonfarm employment	1.6	1.3	-5.8	2.8	3.5	-0.5
Personal income (billions,	17,706.0	18,424.4	19,627.6	21,092.8	21,725.6	22,420.8

USD)						
Percent change in personal income	5.1	4.1	6.5	7.5	3.0	3.2
Civilian unemployment rate (percent)	3.9	3.7	8.1	5.3	3.8	4.4
CPI-U (annual percent change)	2.4	1.8	1.2	4.7	8.1	4.0
Source: The Selig Center for Economic Growth, University of Georgia Terry College of Business, November 7, 2022.						