The US, Illinois and Chicago Outlook for 2018

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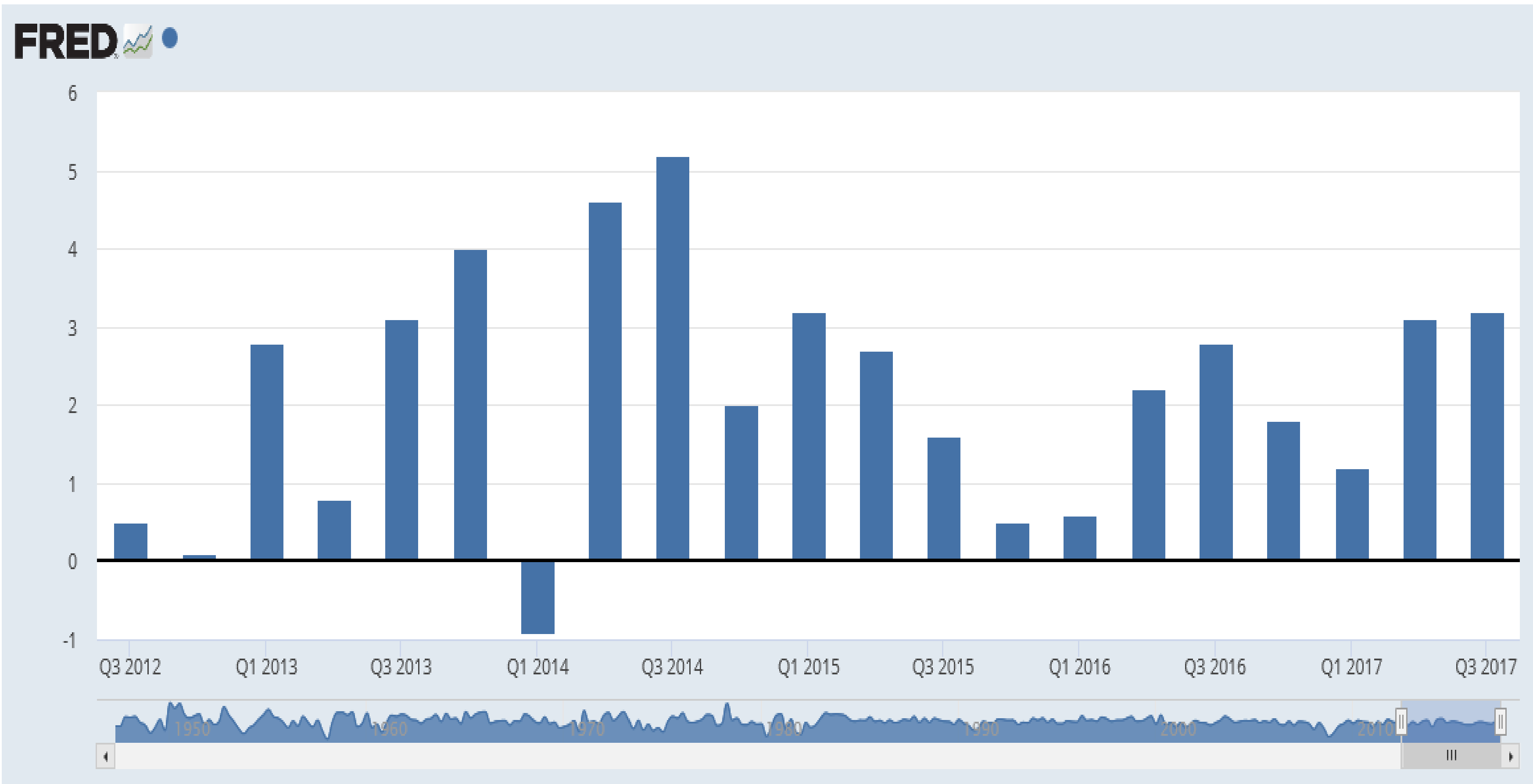
A Better Than Expected 2017

- Everything basically went right in 2017
  - Unemployment continued to fall (4.1%)
  - Consumer confidence hit lofty levels
  - Household wealth hit a record (almost $97 trillion)
  - World economy entered into expansion
  - 2nd and 3rd Quarter GDP exceeded 3%
  - Wages started to rise meaningfully
  - Record stock market levels

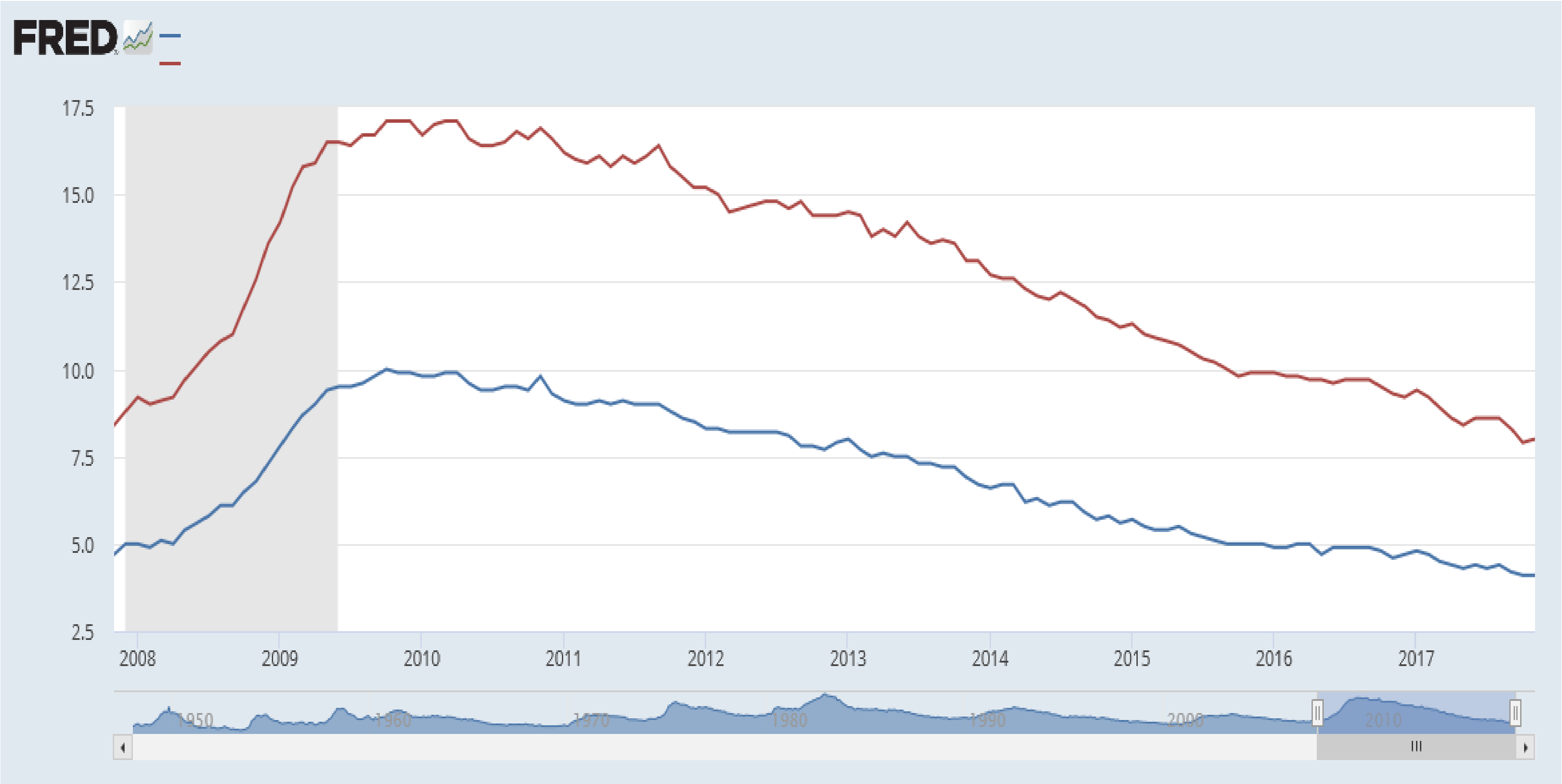
How about 2018?

- Plenty of reasons to be optimistic
  - Economy has momentum
  - World economic expansion looks likely to continue
  - The tax stimulus will start to kick in

US GDP—above 3% in Q2 and Q3



Unemployment has fallen to 4.1% and the broader U-6 measure has dropped to pre-recession levels



Atlanta Fed Wage Tracker, above 3% for 2017

Consumer Sentiment Strong and Rising

Latest projections

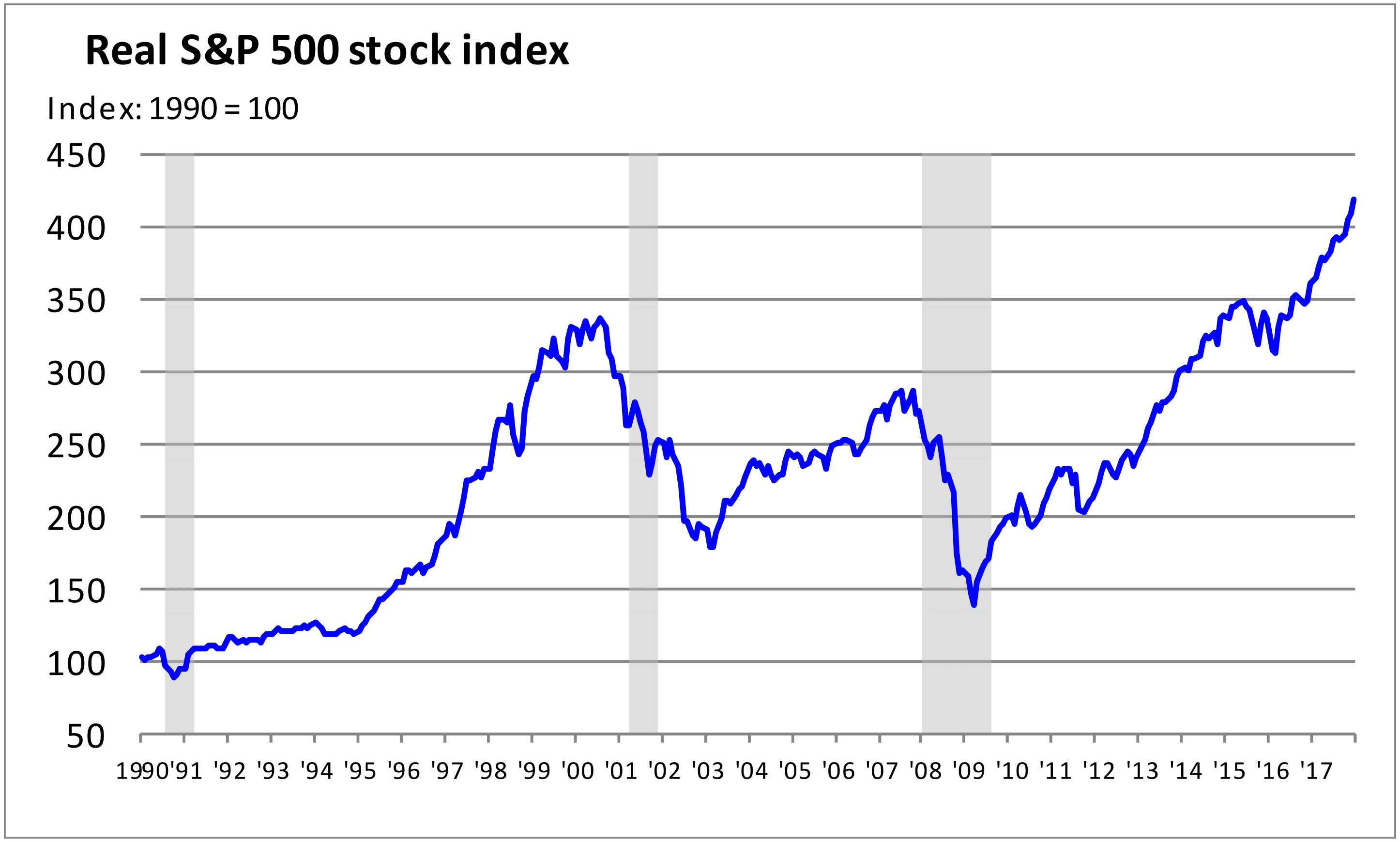
The global recovery is continuing, and at a faster pace.

(percent change)

		Projections	
	2016	2017	2018
World Output	**3.2**	**3.6**	**3.7**
Advanced Economies	**1.7**	**2.2**	**2.0**
United States	1.5	2.2	2.3
Euro Area	1.8	2.1	1.9
Germany	1.9	2.0	1.8
France	1.2	1.6	1.8
Italy	0.9	1.5	1.1
Spain	3.2	3.1	2.5
Japan	1.0	1.5	0.7
United Kingdom	1.8	1.7	1.5
Canada	1.5	3.0	2.1
Other Advanced Economies	2.2	2.6	2.5
Emerging Market and Developing Economies	**4.3**	**4.6**	**4.9**
Commonwealth of Independent States	0.4	2.1	2.1
Russia	–0.2	1.8	1.6
Excluding Russia	1.9	2.9	3.3
Emerging and Developing Asia	6.4	6.5	6.5
China	6.7	6.8	6.5
India	7.1	6.7	7.4
ASEAN-5	4.9	5.2	5.2
Emerging and Developing Europe	3.1	4.5	3.5
Latin America and the Caribbean	–0.9	1.2	1.9
Brazil	–3.6	0.7	1.5
Mexico	2.3	2.1	1.9
Middle East, North Africa, Afghanistan, and Pakistan	5.0	2.6	3.5
Saudi Arabia	1.7	0.1	1.1
Sub-Saharan Africa	1.4	2.6	3.4
Nigeria	–1.6	0.8	1.9
South Africa	0.3	0.7	1.1
Low-Income Developing Countries	3.6	4.6	5.2

Source: IMF, *World Economic Outlook*, October 2017.

The real value of the stock market has reached new highs



How to think about the tax stimulus?

- Will clearly boost growth but how much and for how long?
- The final version loads a significant amount of stimulus into 2018 ($200 billion)
  - Cuts are immediate
  - Overseas cash repatriation
  - Full expensing of capital
- However, with tight labor markets and a surge in demand, will inflation pick up?
- Estimates of boost to GDP range from 0.3% to over 1%

More on the tax package

- A Barclays research report suggests that (on average) S & P 500 companies will see effective tax rates drop from 26% to 20.7% with rise in earnings per share of 6.3%.
- Repatriation (if the experience from 2004 is a guide) may lead to significant acquisition binge.
- The dollar will strengthen if the interest rate spreads vs other currencies widen.
- Biggest economic impact may be on interest rates. Many predict 10 year treasury yields will hit 3%.

Who wins under tax reform?

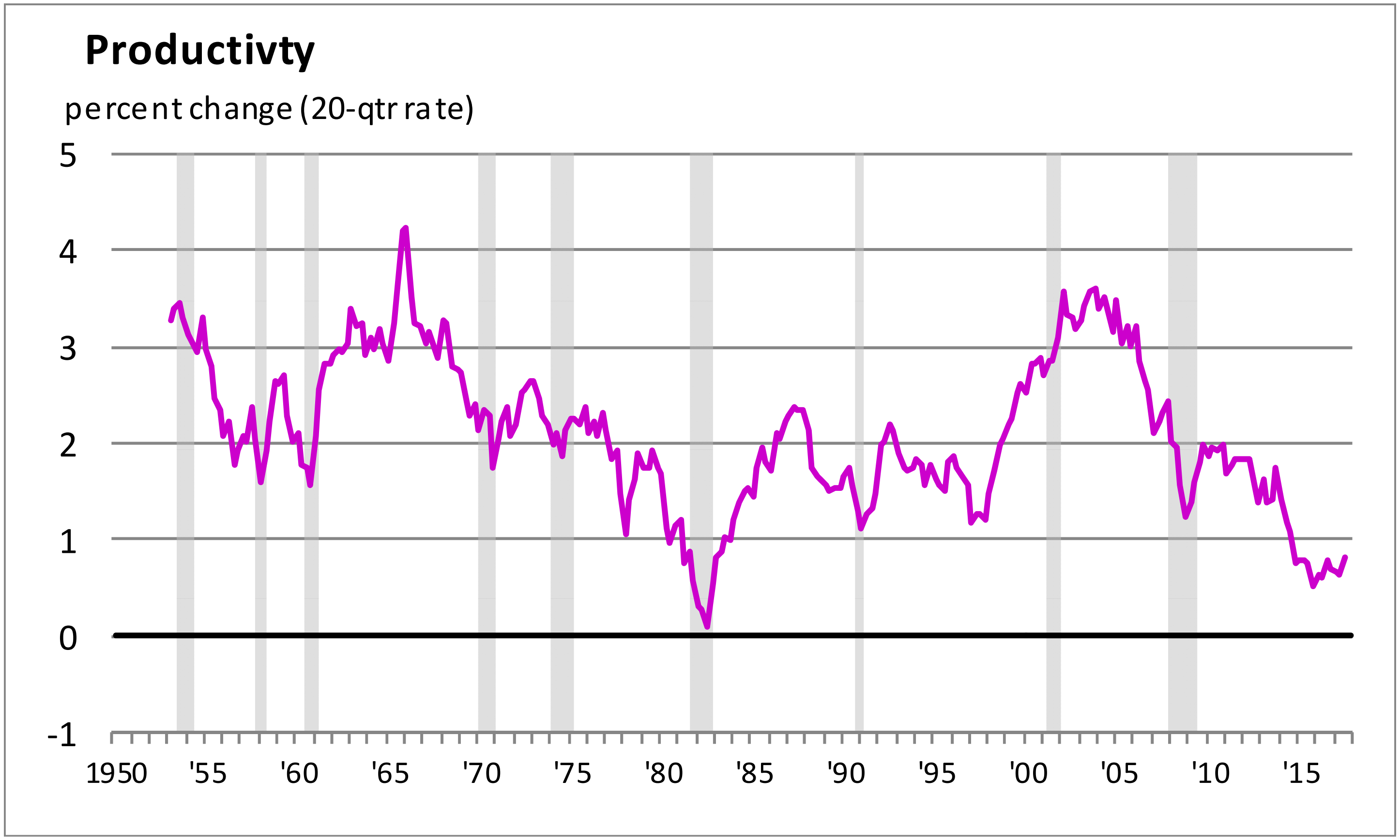
- Corporate profits should be up
- Retail sales should increase
- Surge in capital purchases

(possible victim will be bonds and treasuries if inflation spikes causing the Fed to hike more than 3 times in 2018)

In the long run…

- Still a balancing act…unlikely that the tax package doesn't expand the deficit. As such we are pulling growth forward from future years.
- Timing of fiscal stimulus isn't ideal…tight labor market and rising interest rates
- Underlying economic factors still suggest reduced potential growth in the future…bad demographics, productivity rut.
- In the long run, for the cuts to be most effective, productivity has to surge. Businesses need to invest and expand, not just buy back stock or increase dividends.

This is the indicator to watch…given population trends, productivity is the key to growth in the future



The Current Forecast

- Last FOMC (December, 2017) central tendency projection for GDP growth in 2017 is 2.4% to 2.5%. Long-run 1.8% to 2.0%. Growth in 2018 at 2.2% to 2.6%. (Both revised up from September)
- Inflation still running below the 2% target for PCE. FOMC forecast has PCE at 1.6% to 1.7% in 2017. Long-run estimate is at 2%, with 2018 projected at 1.7% to 1.9%.
- FOMC forecast has unemployment 4.1% (2017), 3.7% to 4.0 % (2018). Long-run—4.5% to 4.8%
- Fed policy. December, 2017 was the fifth quarter point increase since 2008 (1.25% to 1.50% Fed Funds rate). Big issue will be the pace of potential future increases to get to "normalization" (now 2.8% to 3.0%). Expectation is for 3 possible rate hikes in 2018. Other significant news was plan for reducing the Fed balance sheet.

Turning to the Region

- Illinois—recent momentum in Chicago economy is spilling over to the metro region. Chicago was named top metro for corporate investment by Site Selection for the 4th year in a row.
- However, Chicago's economy is changing. Out-migration from the Southside while downtown and areas immediately adjacent boom.
- City is still a business services and HQ mecca but now tech has grown in importance. However, some of the HQ influx is at the expense of suburbs and downstate.
- Southern metro Chicago is still key for logistics/warehousing and manufacturing.

The Changing Economy of Metro Chicago

- Since the end of the Great Recession, downtown Chicago is leading the region in job growth. IDES reports that private sector jobs grew 16.6% (168,000) over the last 7 years in Chicago vs 11.2% for the metro area minus Chicago.
- For the first time ever, the majority of Chicago jobs are in the Central City.
- In the metro counties, Will and DuPage have done well but suburban Cook has underperformed (actually lost jobs in 2017)

RECESSION REBOUND

CHANGES IN CHICAGO-AREA EMPLOYMENT SINCE THE GREAT RECESSION

	March 2010	March 2017	Change	Percent change
Total metro	3.1 million	3.6 million	422,928	13.5%
Cook County	2.0 million	2.3 million	242,855	12.1%
Chicago	1.0 million	1.2 million	168,304	16.6%
Downtown Chicago	479,199	593,665	114,466	23.9%
Cook without Chicago	992,981	1.1 million	74,551	7.5%
DuPage County	484,910	565,134	80,224	16.5%
Kane County	155,665	175,520	19,855	12.8%
Lake County	257,955	284,927	26,972	10.5%
McHenry County	74,895	80,857	5,962	8.0%
Will County	155,494	202,554	47,060	30.3%

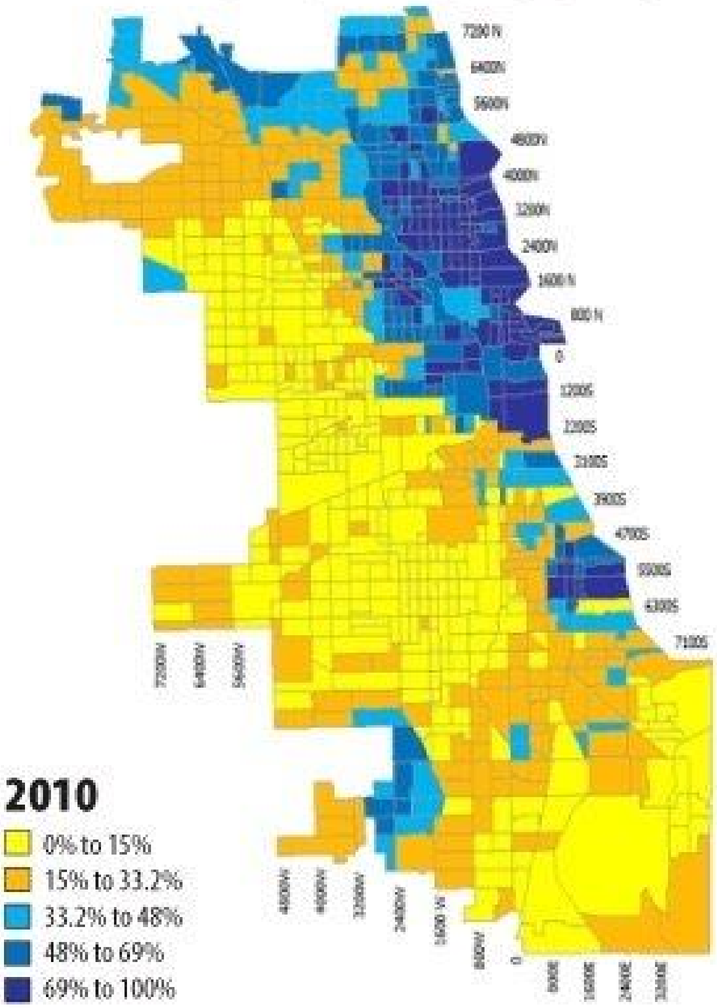
Note: Figures are for unemployment-insurance, private-sector jobs.

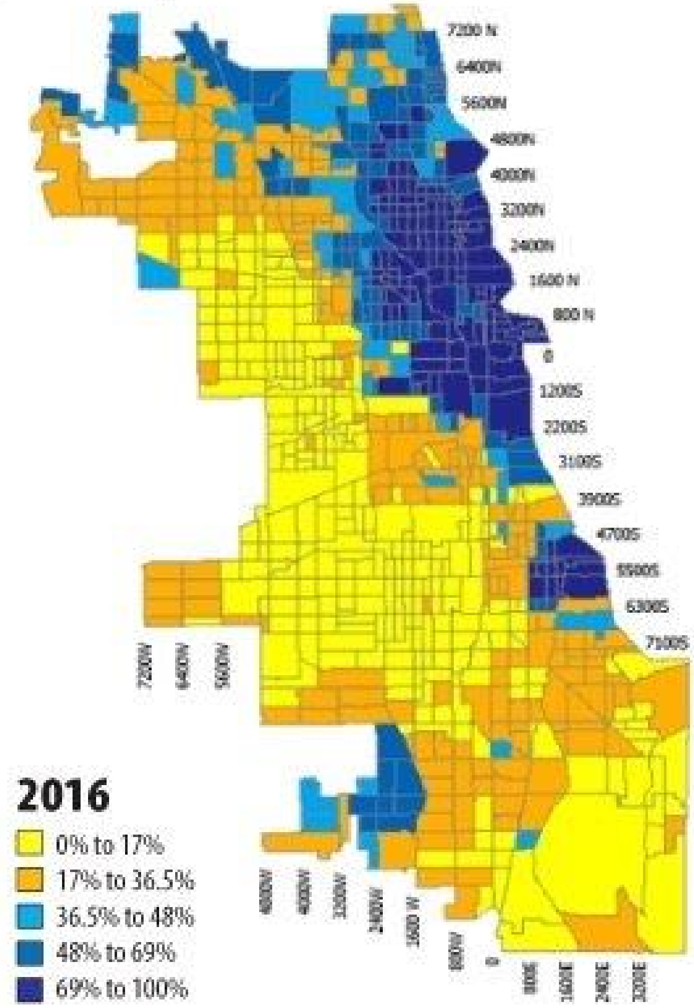
Source: Illinois Department of Employment Security's "Where Workers Work" publication.

Why is downtown booming?

- HQ relocations in search of millennial talent
- Excellent big city amenities
- High-income job mix—particularly business services
- Chicago is still cheap relative to peer big cities
- However, Chicago's success is still very much a Tale of Two Cities

PERCENTAGE OF RESIDENTS AGE 25+ WITH A BACHELORS DEGREE OR HIGHER





What isn't booming?

- Pretty much the rest of Illinois
  - Population trends are depressing…since the 2010 Census, Illinois is the only top 10 state to be smaller (-29,000) and now ranks 6th, behind Pennsylvania.
  - While outmigration is a problem, the real problem is a lack of in-migration. Illinois benefitted from primarily Mexican immigration in the 1980s and 1990s.
  - Bigger problem is we are losing gross income. IRS reports that in tax year 2015, Illinois lost $4.75 billion (net) of adjusted gross income to other states.

Illinois Real GDP vs the Midwest and the U.S.

(%change 2007 to 2016)

Industry	Illinois	Midwest (-Illinois)	U.S.
All industries	3.8	9.1	10.7
--manufacturing	-1.1	-0.4	-0.3
--wholesale trade	4.5	6.1	3.7
--retail trade	1.7	14.0	11.5
--transportation and warehousing	-1.1	2.1	5.4
--finance, insurance, real estate	7.7	13.9	13.6
--professional and business services	11.6	22.8	21.7
--education, healthcare	13.6	15.4	21.5
--government	-5.6	-1.5	2.4

A final thought…Possible implications of tax reform for local governments

- It depends…are local property taxes greater than $10,000 and will taxpayers still itemize?
- The property tax exemption will compete with the state income tax exemption since the cap is $10,000 for all state and local taxes.
- Economic theory suggests that property taxes are capitalized into house prices…high property taxes already lower housing values unless local services are so desirable that they compensate.
- Now the "tax price" will rise without any service offset. Housing prices should adjust down and so will the value of taxable property.
- Also gone is tax-exempt status for advanced refunding bonds (although private activity bonds were protected).

Possible impacts on Muni bonds and debt

- Most suggest that the bill will result in higher borrowing costs. Why?
  - Lower corporate tax rates will make it less attractive for banks and insurance companies to buy munis since they will be able to make more off of taxable investments. (Banks and insurance companies are currently 28% of the market)
  - A technical trigger in some borrowing agreements allow the lender to increase charges if a corporate tax cut occurs. (ex. A Florida city will pay $711,000 more in interest because of the tax cut)
  - Better news is that wealthy individuals who exceed the $10,000 cap for SALT deductions may want to shield more money in tax-exempt bonds to lower their taxable income.

Questions?

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