Bell Bank

Commercial Insights

Q4 2022

Rising Business Risks from Fed Policy and Slowing Growth

As we enter the final quarter of the year, the economy and financial markets continue to struggle with rising inflation and slowing growth. Many economic measures have decelerated nationally and across the Midwest, including gross domestic product, job openings and manufacturing activity. These are all signs that inflation is taking its toll, leading many economists and business leaders to worry about the balance that must be struck by the Federal Reserve as it navigates this historic period. In this challenging economic environment, what should business leaders expect and what can they do to prepare their businesses in the years ahead?

How Did We Get Here?

It's helpful to discuss why inflation is rising and growth is slowing. During the pandemic, supply chains were disrupted as factories shut down, ports were closed, and international trade faltered. These supply chain problems led to rising prices across a variety of goods. For example, because of the shortages of semiconductors and other imported parts, auto manufacturers were forced to slow or even halt production. This caused automobile prices to skyrocket, and they remain high today.

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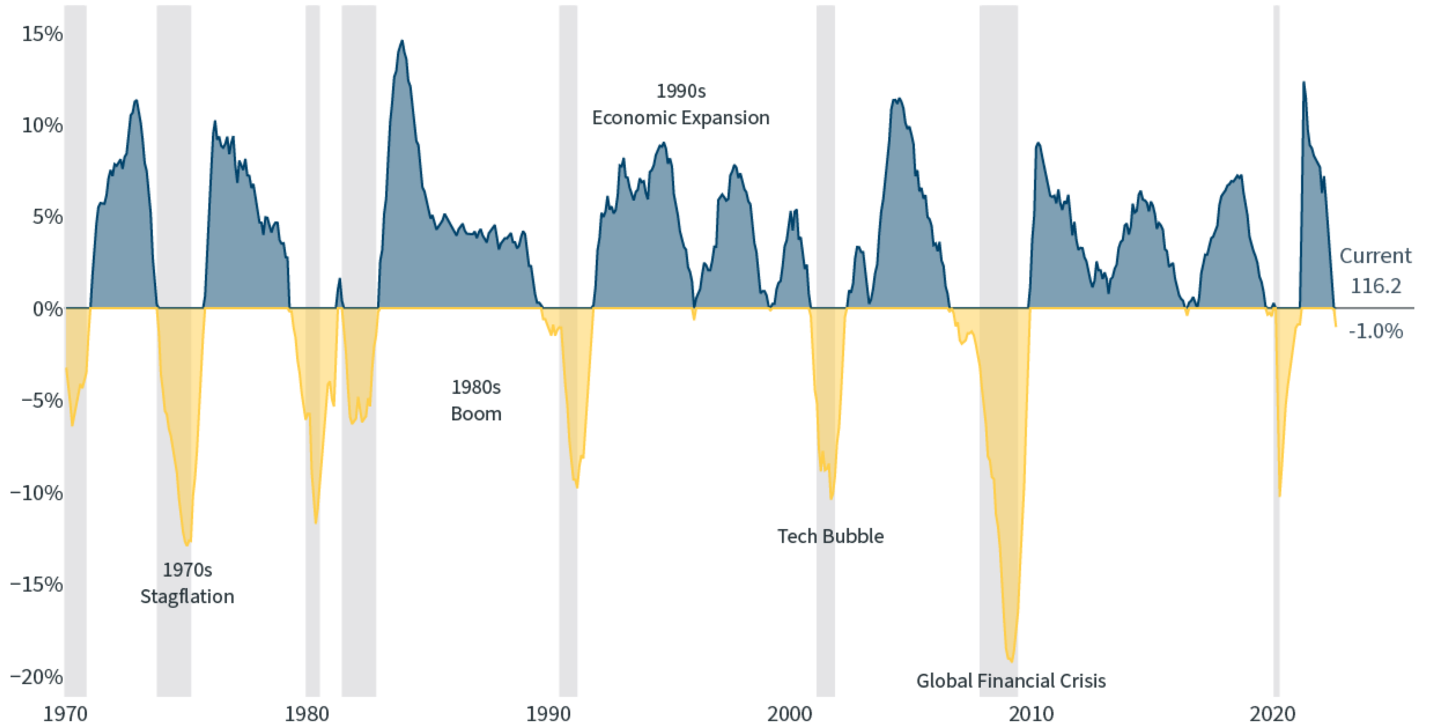
Slowing Economic Growth

Conference Board LEI year-over-year percent change
Recessions are shaded



Latest data point is Aug 2022
Sources: Clearnomics, Conference Board, NBER, Refinitiv

In response, the Federal Reserve, Federal Government, and State Governments responded by enacting policies to provide liquidity to markets and support the economy through trillions of dollars of asset purchases, stimulus and spending. This led to a rapid recovery in 2020 and 2021, making the pandemic recession the shortest on record at only two months in duration. In contrast, the recovery in the unemployment rate following the 2008 financial crisis took nearly eight years.

The combination of a recovering economy, acute shortages, the war in Ukraine, and economic stimulus led prices to begin to rise in the first half of 2021. While supply chains have improved and oil prices have come down over time, inflation remains high and there are signs that it has broadened across many categories.

Fed Intervention

In response to high inflation, the Fed has now raised rates five times in 2022 and is expected to continue doing so through much of 2023. This has included three consecutive 75 basis point rate hikes that have brought the current target rate to 3%, the highest since 2008. The Fed has accelerated these hikes due to concerns that it is falling behind accelerating inflation. In June of 2022, the Consumer Price Index reached 9.1%, its highest level since the 1980s, before slowing on the back of oil price declines.

More recently, the Fed has communicated that it will keep rates higher for longer. This has not only led to significant swings in financial markets but is one reason that some economists worry about a recession next year. This is because higher rates increase the cost of capital across the economy which slows activity. While a recession is not yet certain, and there are still bright spots in the economy, the Fed does need to walk a fine line between fighting inflation and slowing growth further.

Market expectations have also shifted this year. Measures such as fed funds futures now suggest that the Fed could raise rates to 4.25% by the end of the year and as high as 4.5% next year, a significant jump in just the last couple of months. This has also pushed out the time horizon for returning to a more normal level of inflation.

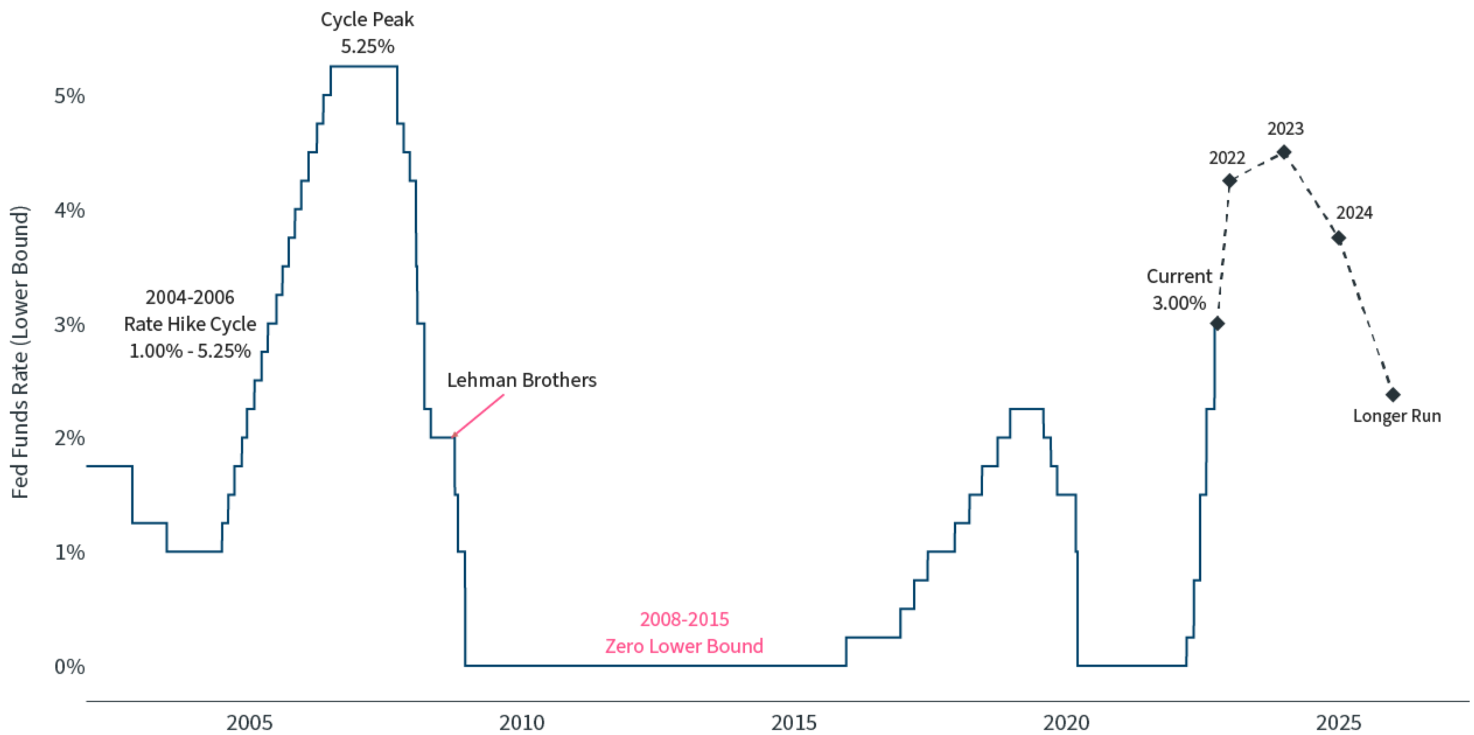
Economic Consequences for Midwest Business Leaders

Given this challenging economic backdrop, how should business leaders react? Three important factors are at the forefront: how will the labor market, inflation, and interest rates evolve over the coming years?

First, business leaders everywhere are struggling with hiring even when there is robust customer demand. Unemployment rates across the country have reached

Federal Funds Rate

Target range lower limit



Latest data point is Oct 2022

Sources: Clearnomics, Federal Reserve

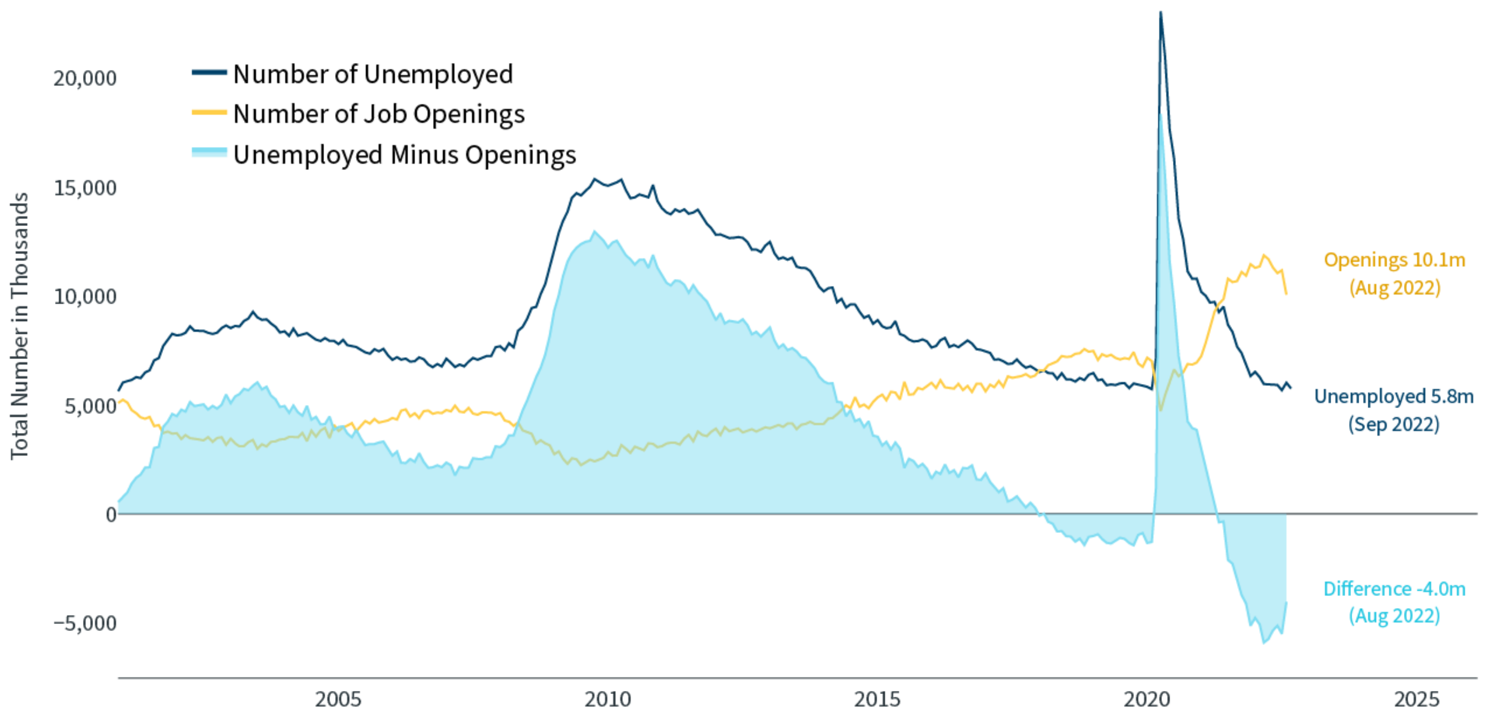
pre-pandemic lows as the labor market has shown significant strength. While the national job openings level has declined a bit, there are still millions more job openings than unemployed individuals.

In the Midwest this pattern is even more extreme with the unemployment rate reaching 3.4%. While the strength of the labor market may insulate the country as a whole and the Midwest from a sharp economic downturn, it has further complicated business operations as qualified workers are hard to find and demand high salaries. If the labor market remains tight wages may continue to rise as competition for workers accelerates. In addition, these effects could further feed into inflation as businesses must raise their prices to keep pace with rising wages.

Second, inflation continues to raise costs across industries. Not only are wages higher, but also the costs of basic goods and services have increased.

Unemployment and Job Openings

U3 unemployment compared to JOLTS job openings



Latest data point is Sep 2022
Sources: Clearnomics, U.S. Bureau of Labor Statistics

And, although energy prices have declined in recent months, they are still at their highest levels since the early 2010s. Maintaining financial discipline and focusing on profit margins will continue to be the most important things business operators can do.

Finally, both inflation and slowing growth are already impacting interest rates. If inflation continues to accelerate, the Federal Reserve will need to raise short-term rates beyond even current expectations. Long-term rates have risen as well, but not as much as short-term ones due to slowing growth. This has resulted in an “inverted” yield curve in which shorter duration interest rates are higher than long duration ones. Rising rates have dampened economic activity and will continue to depress growth until inflation is controlled, but for those with long time horizons, longer-term rates could still be attractive relative to historical levels.

Despite their capital intensity, agriculture and manufacturing appear to have weathered inflation and initial interest hikes well compared to industries such as housing and technology. Surveys from the Federal Reserve Bank of Minneapolis show that 98% of farm incomes have increased or stayed the same relative to last year while loan demand has broadly fallen. Manufacturing has similarly expanded in recent months. According to the ISM Survey of Manufacturers, manufacturing has expanded for 27 consecutive months, albeit at a slowing rate.

These figures are positive for the Midwest relative to the rest of the country but, in the current climate of economic uncertainty, many challenges remain. Rising input prices, interest rates, and a tight labor market have forced businesses across industries to adapt to changing financial conditions. Business leaders that can navigate this effectively, and take advantage of investment and growth opportunities, may be better positioned once inflation eases and growth resumes.

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