# Economic Review - Fourth Quarter 2015

The state of the general economy can help or hinder a business' prospects and therefore has a direct impact on the value of a business. The economic recovery following the recession of 2007–2009 continues, but modestly.

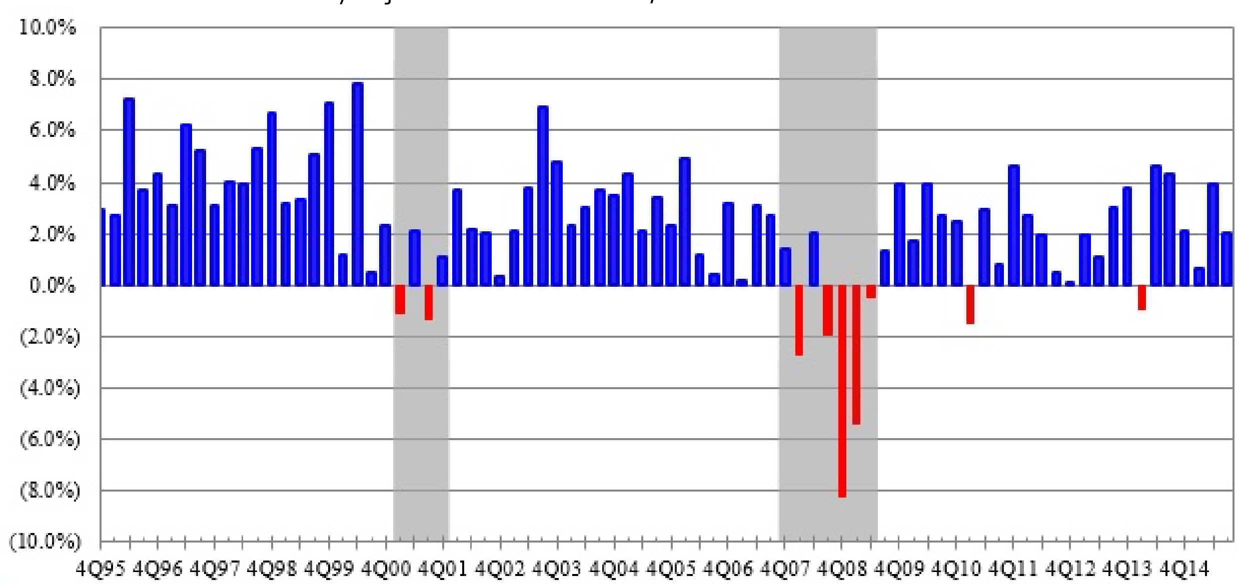
## Summary

Following the December 15–16, 2015, meeting of the Federal Open Market Committee (the "Committee") of the Federal Reserve, the Committee issued a statement that economic activity expanded moderately in the fourth quarter of 2015. Labor market conditions continued to improve, with total non-farm payroll employment expanding at a higher rate in October and November than the previous quarter. Manufacturing production increased in October, despite decreased mining sector output. Business spending growth started to slow, as shipments of non-defense capital goods excluding aircraft declined in October. Spending on commercial structures excluding mining and drilling increased in October. The recovery of the housing sector has been slow, as starts on single-family homes and multi-family units declined, and existing home sales decreased. Building permits, however, have increased and sales of new homes rose in October. Household spending continued to increase as real disposable income grew in September and October, and household net worth was bolstered by recent gains in home values.

## Gross Domestic Product

The U.S. Bureau of Economic Analysis (BEA) estimates that real gross domestic product (GDP) — the output of goods and services produced by labor and property located in the United States — increased at an annual rate of 2.0 percent in the third quarter of 2015. Quarterly GDP data for the preceding 20 years is shown in the following figure.

**QUARTERLY U.S. GDP GROWTH**
Seasonally Adjusted Annualized Rates; Shaded Bar Indicates Recession




*Sources:* U.S. Bureau of Economic Analysis and National Bureau of Economic Research.

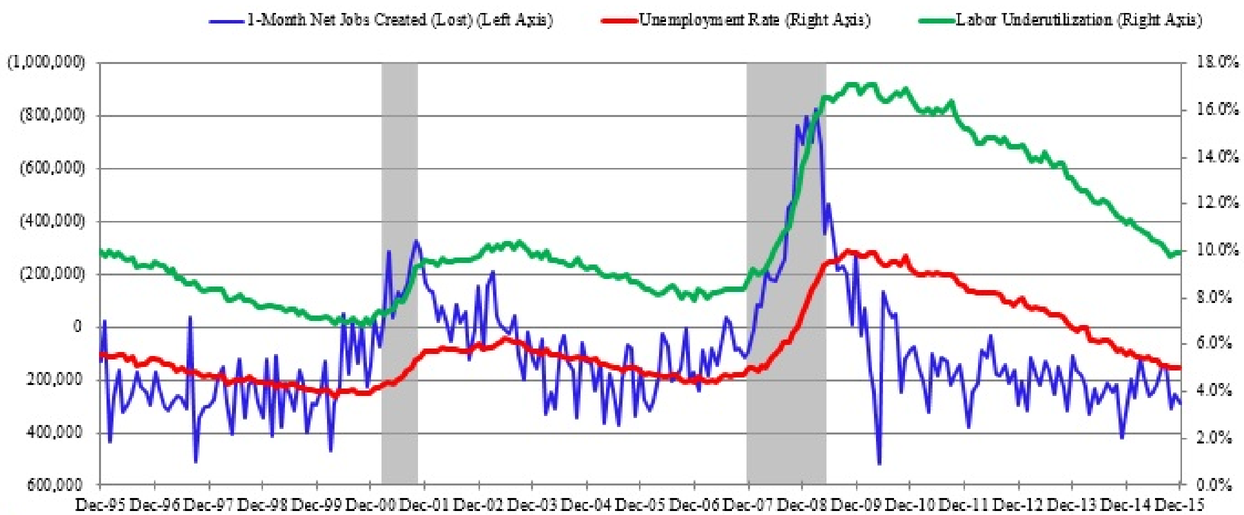
GDP percent change is based on chained 2009 dollars.

## Employment

The employment situation in the United States is improving. In the 25 consecutive months from February 2008 to February 2010, 8.7 million non-farm jobs (net) were lost. In the 70 consecutive months from March 2010 to December 2015, 13.6 million non-farm jobs (net) were created.[1] The unemployment rate peaked at 10.0 percent in October 2009 and has abated to 5.0 percent as of December 2015, the lowest unemployment rate since April 2008.[2] This statistic, however, omits discouraged workers who have left the workforce and part-time workers who would prefer full-time work. A more expansive measure of labor underutilization was a still-elevated 9.9 percent as of December 2015.[3] Underemployment restrains economic growth as consumers are unable or hesitant to spend. The past 20 years of employment data are presented in the following figure.

**MEASURES OF STRESS IN THE LABOR MARKET**

Shaded Bar Indicates Recession




*Sources:* Department of Labor, Bureau of Labor Statistics, and National Bureau of Economic Research. Data represents non-farm payrolls.

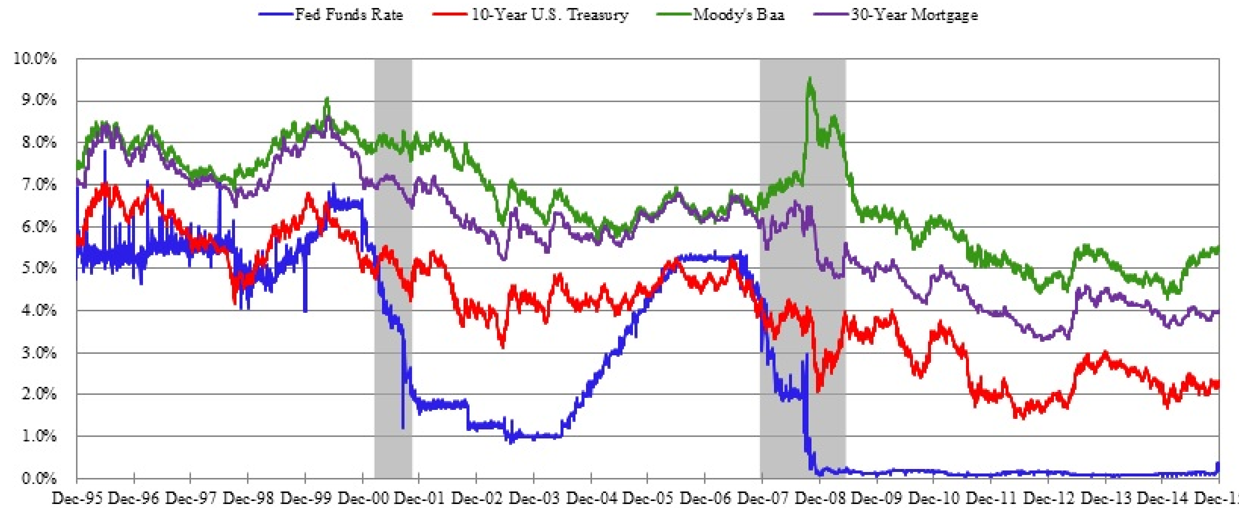
## Interest Rates

The Committee meets periodically to assess economic conditions and determine appropriate policies to fulfill its dual mandate of fostering maximum employment and price stability. At its December 15–16, 2015, meeting the Committee considered the outlook for economic activity, the labor market, and inflation, and weighed the uncertainties associated with the outlook, and raised the federal funds rate to a range of 0.25-to-0.50 percent. In determining the timing and magnitude of future adjustments to the target range, the Committee will assess realized and expected economic conditions relative to its objective of maximum employment and 2 percent inflation. The Committee is continuing its policy of reinvesting proceeds from maturing bonds.

United States financial markets were supportive of economic growth and employment in the fourth quarter of 2015. Corporate bond spreads were little changed and 30-year mortgage rates increased 30 basis points, which was in line with increases in yields on mortgage-backed securities and Treasury bonds. Yields on short- and long-term nominal Treasury securities increased. Growth in the issuance of commercial and industrial loans was solid, and consumer loan balances continued to increase as credit card, automobile, and student loans increased. Financing for commercial real estate has tightened, while market conditions for residential mortgages remained relatively unchanged. Credit availability for borrowers with low credit scores remained tight. The past 20 years of historical interest rate data are shown in the following figure.

**SELECTED INTEREST RATES**

Shaded Bar Indicates Recession




*Source:* Federal Reserve Statistical Release H.15 (519) Selected Interest Rates.

## Current Events

The Standard and Poor's (S&P) 500 stock index rebounded from its decline in the third quarter, bringing the index just slightly into positive territory for 2015 on a total return basis. Most of its recovery occurred in October; however, the index was volatile in the closing weeks of the year as energy stocks declined further due to the Organization of the Petroleum Exporting Countries (OPEC) deciding not to cut back global production, pushing oil prices to 11-year lows. Materials stocks were top performers due to the announcement of large mergers, and health care and information technology stocks performed well during the fourth quarter. The other major indices, the Dow Jones Industrial Average (DJIA), the NASDAQ Composite, the S&P MidCap 400, and the Russell 2000 stock indices, saw solid gains in the fourth quarter. However, the S&P MidCap 400 and the Russell 2000 stock indices finished the year with negative annual returns. Total returns for U.S. stock indices during the fourth quarter of 2015 and the full year 2015 are shown in the following figure.

**TOTAL RETURNS OF MAJOR U.S. STOCK INDICES**

| Index | Fourth Quarter 2015 | 2015 |
|---|---|---|
| S&P 500 | 7.04% | 1.38% |
| DJIA | 7.70% | 0.21% |
| NASDAQ Composite | 8.38% | 5.73% |
| S&P MidCap 400 | 2.60% | (2.18%) |
| Russell 2000 | 3.59% | (4.41%) |

The number of initial public offerings (IPOs) and the amount of capital raised slowed in 2015, with 170 IPOs raising $30 billion (the lowest total proceeds since $21.9 billion in 2009). IPO activity was down from 2014, a decrease from

275 IPOs in 2014. The $30 billion raised in 2015 was a 64.8 percent decrease from 2014; even without Alibaba Group Holdings Ltd.'s $22 billion IPO in 2014, proceeds were down 52.6 percent year-over-year.

Healthcare IPOs were the largest category in 2015, with 78 IPOs (46 percent), taking a larger share of the IPO market than 2014 (37 percent). At the end of 2015, 57 percent of IPOs traded below their offer prices, compared to 41 percent at the end of 2014. The average IPO finished 2015 down 2.1 percent from its offering price (compared to positive 21.0 percent in 2014), below most major indices and negative for the first time since 2011. A number of factors led to the decline in IPO activity, including uncertainties regarding Federal Reserve and European monetary policies, concerns over the Chinese economy, poor IPO performance, declining energy prices, and increases in merger and acquisitions and private market transactions.

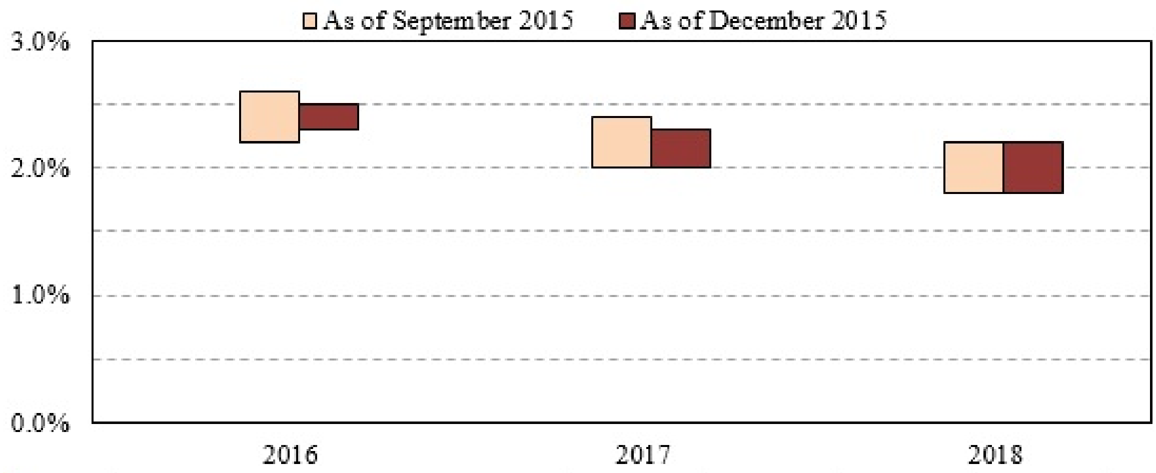
In August 2015, China's central bank, the People's Bank of China (PBOC), allowed its currency, the yuan, to depreciate relative to the U.S. dollar, decreasing the yuan's value by over 3 percent in three days. Since 2005, China's currency has appreciated 33 percent against the U.S. dollar; the currency's devaluation on August 11 marked the largest single drop in 20 years. The PBOC stated that the midpoint for the value of the yuan relative to the U.S. dollar had diverged from market-determined rates and that the PBOC was allowing the market to determine the yuan's value. A shift towards a weaker currency – an approximately 4 percent decline in the yuan's value since August 11 – signals China's potential concern about slowing growth, as China reported economic growth of 6.9 percent in 2015, a 25-year low. Chinese monthly industrial production and retail sales were down in December, with industrial production growing by 5.9 percent in December (down from 6.0 percent in November) and retail sales growing by 11.1 percent (down from 11.3 percent in November). Additionally, customs data reveals exports declined by 1.3 percent in December, an improvement over the 6.8 percent decline in November. Financial markets have reacted negatively to the PBOC's move. As uncertainty surrounds the Chinese economy, other central banks have devalued their currencies to help their own exporters and to prevent destabilizing capital flows. Commodities markets are bracing for lower demand in China, the largest consumer of raw materials.

On August 3, 2015, Puerto Rico defaulted on a $58 milion debt payment, only paying $628,000. In total, Puerto Rico owes about $70 billion of debt to various debtholders. As a commonwealth of the United States, Puerto Rico is unable to file for Chapter 9, Title 11 bankruptcy under the United States Bankruptcy Code, which is available exclusively to U.S. municipalities, to restructure its debts. Puerto Rico is instead seeking significant concessions from its creditors, which could include deferring some debt payments for as long as five years. Governor Alejandro García Padilla announced in December 2015 that Puerto Rico will default on nearly $174 million in principal and interest payments on January 4, 2016, including $35.9 million due to holders of bonds issued by its Infrastructure Financing Authority and $1.4 million due to holders of bonds issued by its Public Finance Corporation. The Puerto Rican government will divert this $174 million amount from lower-grade bonds to pay holders of the legally protected general obligation bonds. As of December 31, 2015, the economic impact of the Puerto Rican debt crisis remains uncertain.

## Outlook

Various statistical reporting agencies provide estimates of the U.S. economy's near-term and longer-term growth rates. The U.S. economy's projected growth rates for 2016–2018 are generally unchanged from September to December. The estimates for U.S. GDP growth are presented in the following figure.

**U.S. GDP GROWTH ESTIMATES**




*Source*: Federal Reserve.

The U.S. Department of the Treasury's November 2015 Monthly Treasury Statement of Receipts and Outlays of the United States Government states that the federal budget deficit for fiscal year 2015 was $439 billion, a decrease of 9.1 percent from $483 billion in fiscal year 2014. For the first two months of fiscal year 2016, the federal budget deficit was $201 billion.[4] The CBO's August 2015 report expects that the growth in real GDP from 2015 through 2019 will be driven largely by consumer spending and business and residential investment.[5] Real GDP is projected to grow 2.0 percent in calendar year 2015, 3.1 percent in calendar year 2016, and 2.7 percent in 2017. By the end of 2017, the CBO estimates that the gap between actual GDP and the economy's potential (that is, maximum sustainable) GDP will be eliminated.[6] Real GDP is expected to grow, on average, at an annual rate of 2.2 percent from 2018 through 2019 and 2.1 percent from 2020 through 2025.[7]

Inflation, as measured by the Core Consumer Price Index, which excludes the effects of food and oil, is forecast to be 2.0 percent in 2015, 2.1 percent in 2016, 2.3 percent in 2017, and eventually increase to an average of 2.3 percent per year in the 2018–2024 period.[8] Although the global economy continues to recover from the severe recessionary shocks that began in 2007, the process has been slow and uneven.



*Endnotes:*

1. Bureau of Labor Statistics. "Employment, Hours, and Earnings from the Current Employment Statistics survey (National)." <http://data.bls.gov/timeseries/CES0000000001?output_view=net_1mth>.

2. Bureau of Labor Statistics. "U-3 total unemployed, as a percent of the civilian workforce (official unemployment rate)". Reported on a seasonally adjusted basis. <http://www.bls.gov/news.release/empsit.t15.htm>.

3. Ibid. "U-6 total unemployed, plus all persons marginally attached to the labor force, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all persons marginally attached to the labor force." Reported on a seasonally adjusted basis.

4. U.S. Department of Treasury, "November 2015 Monthly Treasury Statement of Receipts and Outlays of the United States Government," December 2015. <https://www.fiscal.treasury.gov/fsreports/rpt/mthTreasStmt/mts1115.pdf>.

5. U.S. CBO, "An Update to the Budget and Economic Outlook: 2015–2025," August 2015. <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/50724-BudEconOutlook-3.pdf>.

6. Ibid.

7. Ibid.

8. Ibid.