Economic Review - First Quarter 2019

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Summary

The state of the general economy can help or hinder a business' prospects by influencing the demand for its goods and services and the availability and price of inputs such as capital and labor. The prevailing economic conditions therefore directly impact the value of a business at a specific point in time. The economic expansion that began in June 2009 is the second longest since the 1850s,[1] but growth has been modest, especially considering the severity of the "Great Recession" of 2007–2009. Recoveries after severe recessions have historically been more robust, as the economy recovers lost ground.

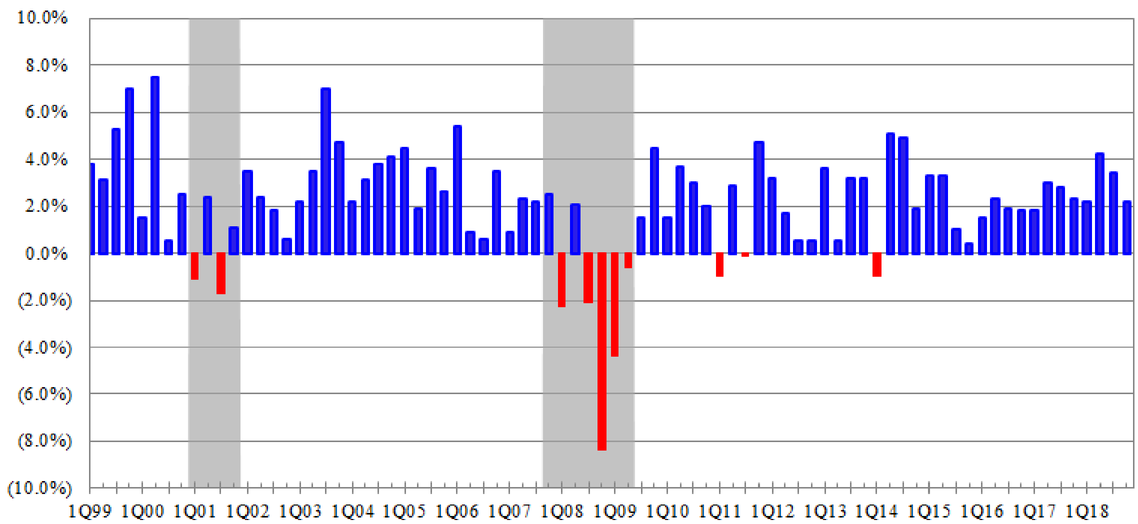
Following the March 19-20, 2019, meeting of the Federal Open Market Committee (the "Committee") of the Federal Reserve, the Committee issued a statement that economic growth moderated in the first quarter of 2019. Labor market conditions remained strong in the first quarter as non-farm payroll employment expanded, the unemployment rate remained low at 3.8 percent in March, and the labor force participation rate rose. Additionally, the rate of private sector job openings remained near the previous quarters' high levels, and average hourly earnings increased 3.4 percent over the 12 months ending in February.[2] U.S. consumer price inflation and core price inflation, which excludes consumer food and energy prices, remained close to the Committee's long-run objective of 2.0 percent.

Industrial production data was mixed, but manufacturing output decreased in the first quarter of 2019. Household spending moderated in the first quarter due to a weak January. Housing activity varied in the first quarter, with starts on single-family homes rising only slightly, while starts on multi-family units declined. Issuance of building permits continued to fall throughout the first quarter, and sales of new and existing homes declined in January. Real private expenditures slowed in the first quarter. Nominal shipments and new orders of non-defense capital goods excluding aircraft grew in January and are expected to have modest, if any, growth, in the near-term. Additionally, real business spending for nonresidential buildings grew in January, and the number of crude oil and natural gas rigs in operation expanded throughout the first quarter.

Gross Domestic Product

The U.S. Bureau of Economic Analysis 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 2.2 percent in the fourth quarter of 2018. 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

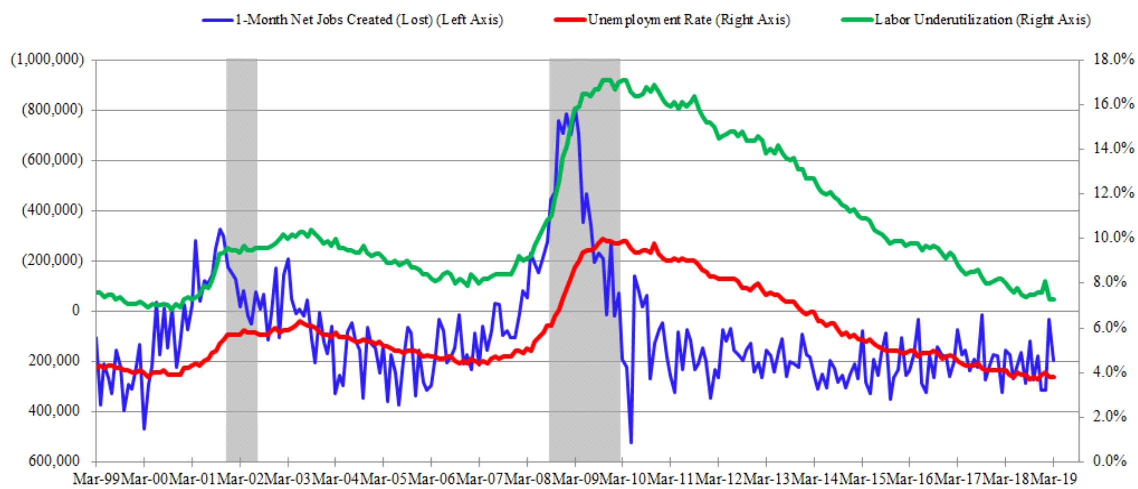


Sources: U.S. Bureau of Economic Analysis and National Bureau of Economic Research. GDP percent change is based on chained 2012 dollars.

Employment

Employment conditions in the United States have been improving. In the 25 consecutive months from February 2008 to February 2010, 8.7 million non-farm jobs (net) were lost. In the 109 consecutive months from March 2010 to March 2019, 21.1 million non-farm jobs (net) were created.[3] The unemployment rate peaked at 10.0 percent in October 2009, fell to a 49-year low of 3.7 percent in September 2018, and was 3.8 percent in March 2019.[4] A more expansive measure of labor underutilization, including discouraged workers who have left the workforce and part-time workers who would prefer full-time work, was 7.3 percent as of March 2019, an 18-year low.[5] Unemployment and underemployment restrain 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



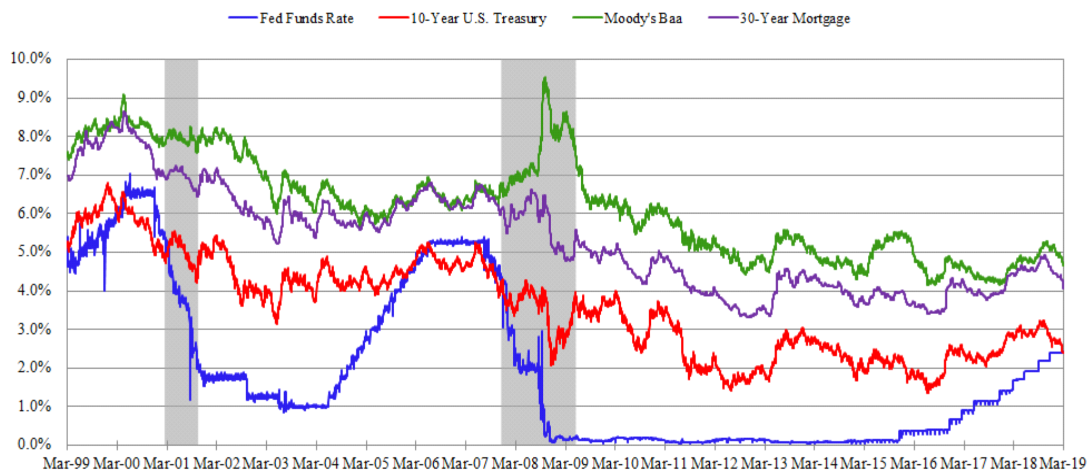
Sources: Department of Labor, Bureau of Labor Statistics, and National Bureau of Economic Research. Data represents non-farm payrolls.

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 March 19-20, 2019, meeting, the Committee considered the outlook for economic activity, the labor market, and inflation. The Committee weighed the uncertainties associated with the economic outlook and maintained the federal funds rate at a range of 2.25-to-2.50 percent. The Committee expects that no more rate increases will occur in 2019.

United States financial markets matched the trend of a slowing economy in the first quarter of 2019. Corporate bond spreads, 30-year mortgage rates, and short-term Treasury yields all rose only slightly in the first quarter, and they remained near the lower end of their historical range. In addition, long-term Treasury yields decreased during the quarter, reflecting a flattening of the yield curve. Measures of inflation based on treasury-inflation-protected securities increased modestly, although they remain below recent levels. Municipal bond issuance remained accommodative in the first quarter. The issuance of institutional leveraged loans and corporate bonds both stabilized at their average levels in the first quarter following a weak performance in recent months. Financing conditions for consumers remained supportive of growth in household spending. Conditions for commercial real estate loans remained accommodative and consistent with previous quarters. Conditions for residential mortgage financing remained accommodative for most borrowers; however, the demand for mortgage credit lightened even as mortgage rates continued to be relatively low. 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.

Stock Market Activity

The first quarter of 2019 experienced a large rebound from a historically poor fourth quarter of 2018, with most major U.S. stock market indices reporting double digit gains. The sizable gains during the first quarter erased most of the major losses in the fourth quarter of 2018, and left most benchmarks within range of their all-time highs.[6]

The first quarter of 2019 began with optimism following an announcement in January from Federal Reserve Chair Jerome Powell that it would be unlikely that the Committee would raise the federal funds rate for the remainder of the year. The Chair further reassured investors in March after largely echoing his statement from January. The Chair also reiterated that the Federal Reserve would not hesitate to use the depth of their tools to help mitigate an economic downturn. This supportive sentiment helped push major stock market indices to large gains throughout the first quarter. In addition, gradual progress in trade negotiations between China and the United States also helped calm investors who were pessimistic regarding the trade dispute.

As discussed, all the major stock market benchmarks posted sizable gains in the first quarter. The Chicago Board Options Exchange Volatility Index (VIX) moderated in the first quarter following numerous spikes in the fourth quarter of 2018. The technology sector exceeded all other sectors, driving the NASDAQ Composite Index to the biggest gain among the three main indices, followed by the S&P 500 Index and the Dow Jones Industrial Average Index. The Russell 2000 Index and S&P MidCap 400 also surpassed the S&P 500 and the Dow Jones Industrial Average, signaling small and mid-cap companies enjoyed the rebound during the first quarter even more than large-cap firms did.

The health care sector was the weakest performer after being hindered by notable drug test failures, as well as concerns of CVS Health's growth outlook following its acquisition of Aetna.[7] Total returns for U.S. stock indices during the first quarter of 2019 are shown in the following figure.

TOTAL RETURNS OF MAJOR U.S. STOCK INDICES

Index	First Quarter 2019
S&P 500	13.6%
Dow Jones Industrial Average	11.8%
NASDAQ Composite (1)	16.5%
S&P MidCap 400	14.5%
Russell 2000	14.6%

Note:
(1) Return represents principal only.

The first quarter of 2019 was a weak quarter for initial public offerings (IPOs), with only 18 IPOs raising just $4.7 billion, which marks the lowest deal count in any quarter in three years. IPO activity was hindered by the poor performance of the equity market in December 2018 as well as pessimism brought about from the government shutdown; however, IPO activity followed the pace of the stock market and began to pick up towards the end of the first quarter. The IPO market was propelled towards the end of the quarter due to the highly anticipated IPOs of Lyft and Levi's. Regardless of the uncommonly low deal count in the first quarter, Renaissance Capital's IPO Index still recorded a 31 percent gain in the first quarter, easily outpacing the major indices. IPO activity should rebound to normal levels in the second quarter with the expectation of numerous large companies going public.[8]

Trade

Trade concerns have continued to influence the economy. It remains unclear whether or when a trade deal between the U.S. and China will occur. The US-Mexico-Canada Agreement (USMCA) was signed in November 2018, but will not go into effect until it is ratified by Congress, which does not appear imminent. Respectively, Mexico, Canada, and China represent the top three trading partners of the United States, making U.S. trade policy among these three countries critical to the health of the American economy.[9]

U.S. Federal Government Shutdown

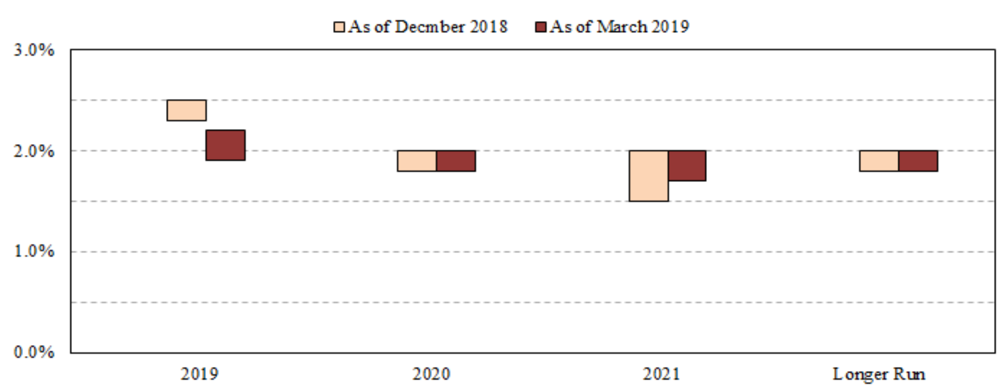
As of December 22, 2018, the U.S. Federal Government failed to pass a continuing resolution to fund roughly 25 percent of its operations which led to a 35 day shutdown lasting until January 25, 2019. The following departments were impacted by the shutdown: the Departments of Commerce, Agriculture, Interior, Transportation, Justice, Treasury, Homeland Security, Housing and Urban Development, and

State. The closure of these nine departments directly impacted an estimated 800,000 federal employees who were either forced to work without pay, or were furloughed for the duration of the shutdown, plus federal contractors and others indirectly employed by the U.S. government.[10] The CBO's January 2019 report noted that the shutdown negatively affected compensation, federal purchases, and private economic activity. Overall, the CBO estimates that real GDP for the first quarter of 2019 will be reduced by $8 billion (0.2 percent) as a result of the shutdown. However, the report also states that this loss to GDP is expected to be short-term, and the shutdown will not affect the level of real GDP in the long-run.[11]

Outlook

Various statistical reporting agencies provide estimates of the U.S. economy's near-term and longer-term growth rates. The Federal Reserve's projected growth rates for the U.S. economy for 2019–2021 decreased slightly from December to March, reflecting the Federal Reserve's tightening monetary policy. The projected growth rates for the longer run remain largely unchanged from December's report. The estimates for U.S. GDP growth are presented in the following figure.

U.S. GDP GROWTH ESTIMATES

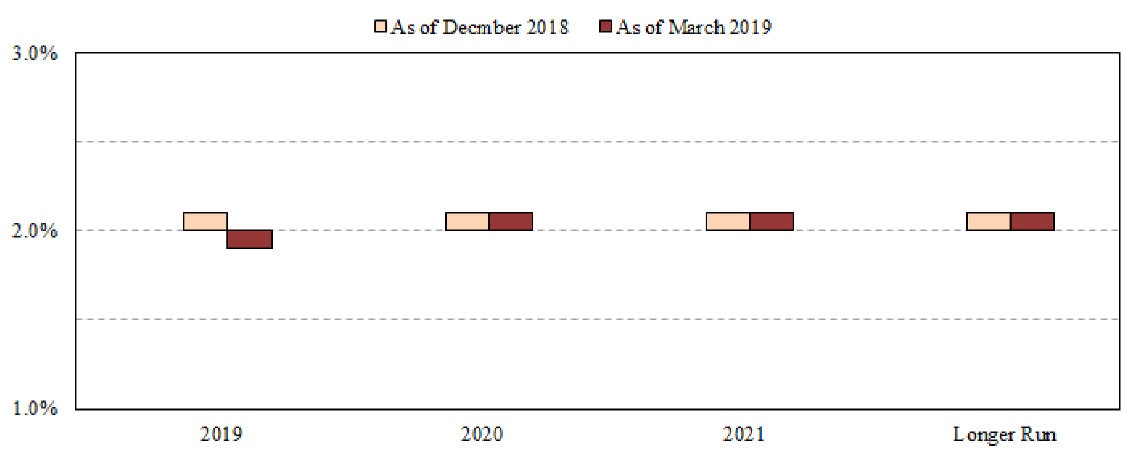


Source: Federal Reserve.

The U.S. Department of the Treasury's February 28, 2019, Treasury Statement of Receipts and Outlays of the United States Government states that the federal budget deficit for the first five months of fiscal year 2019 was $544 billion, in comparison to $391 billion for the same period in fiscal year 2018.[12] The CBO's January 2019 report expects that the growth in real GDP for 2019 will be driven by business investment and government purchases; growth in 2019 will be primarily supported by consumer spending, as well as business and residential investment to a lesser degree.[13] Real GDP is projected to grow 2.3 percent in calendar year 2019, 1.7 percent in calendar year 2020, and 1.6 percent in calendar year 2021.[14] The CBO estimates excess demand to push inflation above the Federal Reserve's 2.0 percent target and drive unemployment lower than the natural rate for 2019 and part of 2020, and then stabilize near their respective long-term rates in the following years. Interest rates are expected to increase as the Federal Reserve has indicated further rate hikes to the Federal Funds Rate in the coming years, which will exert upward pressure on the unemployment rate, which has been below the natural rate since late 2017. Higher interest rates are expected to slow the output growth, and excess demand is expected to begin to diminish after 2019.[15] Real GDP is expected to grow, on average, at an annual rate of 1.7 percent in 2020, 1.6 percent from 2021 through 2022, and 1.8 percent from 2024–2029.[16]

Inflation, as measured by the core personal consumption expenditure (PCE), which excludes the effects of food and energy, is forecast to be 2.0 percent in 2019, 2.2 percent in 2020, 2.1 percent in 2021, and average 2.0 percent per year in the longer run.[17] The core PCE inflation rates are presented in the following figure.

U.S. CORE PCE INFLATION ESTIMATES



Source: Federal Reserve.

Disclaimer: this article has content that is general and informational in nature. This document is not intended to be accounting, tax, legal, or investment advice. Data from third parties is believed to be reliable, but no assurance is made as to the accuracy or completeness.

Endnotes:

1. National Bureau of Economic Research. <https://www.nber.org/cycles.html>.

2. Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/LMJVPRUVUSQ175S>.

3. 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>.

4. 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>.

5. "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.

6. T. Rowe Price, "Quarterly Market Review," April 15, 2019. <https://www.troweprice.com/financial-intermediary/us/en/insights/articles/2019/q1/quarterly-market-review.html>.

7. Ibid.

8. Nasdaq, "Renaissance Capital's 1Q19 US IPO Market Review," April 3, 2019. <https://www.nasdaq.com/article/renaissance-capitals-1q19-us-ipo-market-review-cm1125781>.

9. U.S. Census Bureau, "Top Trading Partners - March 2019," June 11, 2019. <https://www.census.gov/foreign-trade/statistics/highlights/top/top1903yr.html>.

10. Vox, "9 key questions about the longest government shutdown in history, answered," January 16, 2019. <https://www.vox.com/2019/1/16/18182348/9-questions-government-shutdown-explainer>.

11. U.S. CBO, "The Effects of the Partial Shutdown Ending in January 2019," January 28, 2019. <https://www.cbo.gov/system/files/2019-01/54937-PartialShutdownEffects.pdf>.

12. U.S. Department of the Treasury, "Monthly Treasury Statement," February 28, 2019. <https://www.fiscal.treasury.gov/files/reports-statements/mts/mts0219.pdf>.

13. U.S. CBO, "An Update to the Budget and Economic Outlook: 2019 to 2029," January 2019. <https://www.cbo.gov/system/files/2019-03/54918-Outlook-3.pdf>.

14. Ibid.

15. Ibid.

16. Ibid.

17. Ibid.