Economic Review - Fourth Quarter 2019

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 fourth longest since the 1850s, 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.

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.

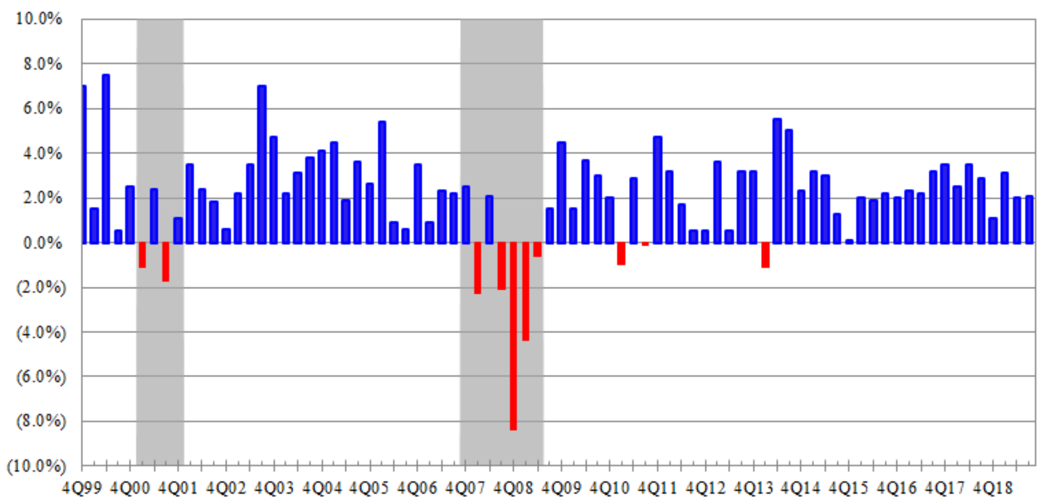
Following the December 10–11, 2019, meeting of the Federal Open Market Committee (the "Committee") of the Federal Reserve, the Committee issued a statement that the economy grew at a moderate rate in the fourth quarter of 2019. Labor market conditions remained strong as non-farm payroll employment expanded and the unemployment rate remained at a 50-year low of 3.5 percent in December. Additionally, the rate of private sector job openings fell slightly in September, but remained near the previous quarters' high levels, and average hourly earnings increased 3.1 percent over the 12 months ending in November.[2] U.S. consumer price inflation and core price inflation, which excludes consumer food and energy prices, increased at rates of 1.4 percent and 1.6 percent, respectively, over the past 12 months ending in October. While the Committee has noted these are below its long-run objective of 2.0 percent, inflation is expected to approach 2.0 percent in the coming years.

Industrial production decreased in the fourth quarter and remained below early 2019 levels. Household spending increased at a stronger than expected pace in the fourth quarter. Housing activity continued to increase following a poor first half of the year, with starts on single-family homes and multi-family units increasing in the fourth quarter. Issuance of building permits rose in the fourth quarter, although sales of new and existing homes were mixed. Real private expenditures declined in the fourth quarter. Nominal shipments and new orders of non-defense capital goods excluding aircraft increased in October after previously poor quarters. Additionally, real business spending for nonresidential buildings decreased, and the number of crude oil and natural gas rigs in operation continued to decline throughout the fourth 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 2.1 percent in the third quarter of 2019. 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

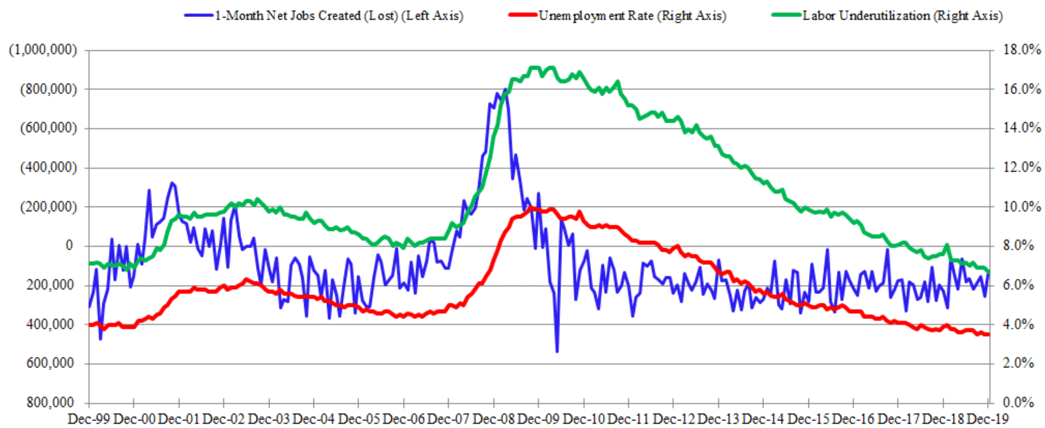


Sources: U.S. Bureau of Economic Analysis and National Bureau of Economic Research.
GDP percent change is based on chained 2012 dollars.

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 118 consecutive months from March 2010 to December 2019, 22.7 million non-farm jobs (net) were created, making it the second longest economic expansion in the U.S. on record (behind the expansion from 1991 to 2001).[3] The unemployment rate peaked at 10.0 percent in October 2009 and remains at a 50-year low of 3.5 percent in December 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, reached a 20-year low of 6.7 percent in December 2019.[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



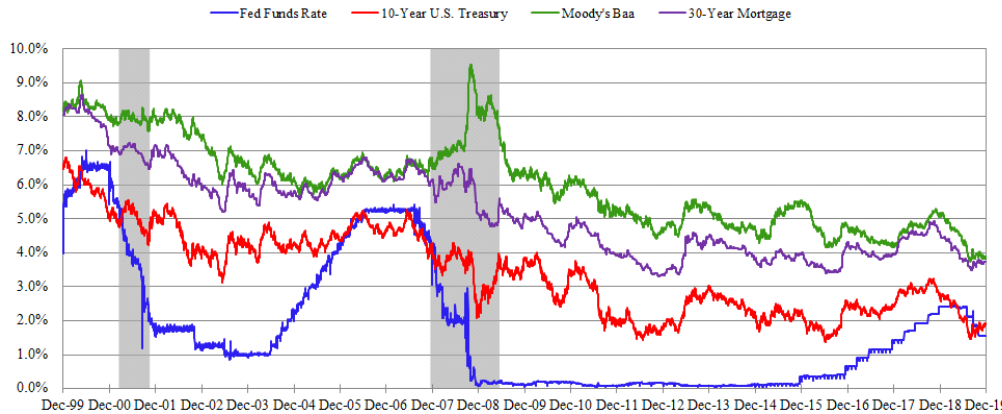
Sources: Department of Labor, Bureau of Labor Statistics, and National Bureau of Economic Research. Data represents non-farm payrolls.

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 October 30, 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 lowered the federal funds rate to a range of 1.50-to-1.75 percent. As of the Committee's most recent meeting on December 10–11, 2019, they stated the federal funds rate range will remain at 1.50-to-1.75 percent and it will closely monitor the impact of incoming information and will act appropriately to sustain the current expansion.

United States financial markets, fueled by growth and trade concerns, fluctuated but remained generally accommodative of spending and economic activity in the fourth quarter of 2019. Corporate bond spreads decreased, while 30-year mortgage rates and short-term Treasury yields were little changed in the fourth quarter, following notable declines in the third quarter. In addition, long-term Treasury yields increased after decreasing in the third quarter, reflecting a flattening of the yield curve. Measures of inflation based on treasury-inflation-protected securities increased above recent multi-year lows. The issuance of corporate bonds remained strong in the fourth quarter. Financing conditions for consumers remained supportive of growth in household spending despite the volatility in the financial markets. Conditions for commercial real estate loans remained accommodative and consistent with previous quarters. Conditions for residential mortgage financing remained accommodative for most borrowers, as mortgage rates continue 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 major indexes' returns were strong in the fourth quarter of 2019 and for the full year. The NASDAQ Composite Index outperformed the major indices in the fourth quarter and in 2019 growing over 12 percent and 35 percent, respectively. Technology stocks led all sectors due to strong growth from Apple and Microsoft, which accounted for nearly 40 percent of the sector's market cap. The S&P 500 Index neared double digit growth in the quarter as well, finishing its best year since 2013. The Dow Jones Industrial Average Index moved higher as well, but was slightly hindered from mixed trade news and poor data on exports. The real estate sector was the lone industry to decline during the fourth quarter of 2019.[6]

The Chicago Board Options Exchange Volatility Index (VIX) reflected the optimism felt in the fourth quarter from mostly positive trade news by subsiding from its highest levels of 2019 and remaining stable throughout the quarter. Total returns for U.S. stock indices during the fourth quarter of 2019 are shown in the following figure.

TOTAL RETURNS OF MAJOR U.S. STOCK INDICES

Index	Fourth Quarter 2019	Year to Date
S&P 500	9.1%	31.5%
Dow Jones Industrial Average	6.7%	25.3%
NASDAQ Composite (1)	12.2%	35.2%
S&P MidCap 400	7.1%	26.2%
Russell 2000	9.9%	25.5%

Note:
(1) Return represents principal only.

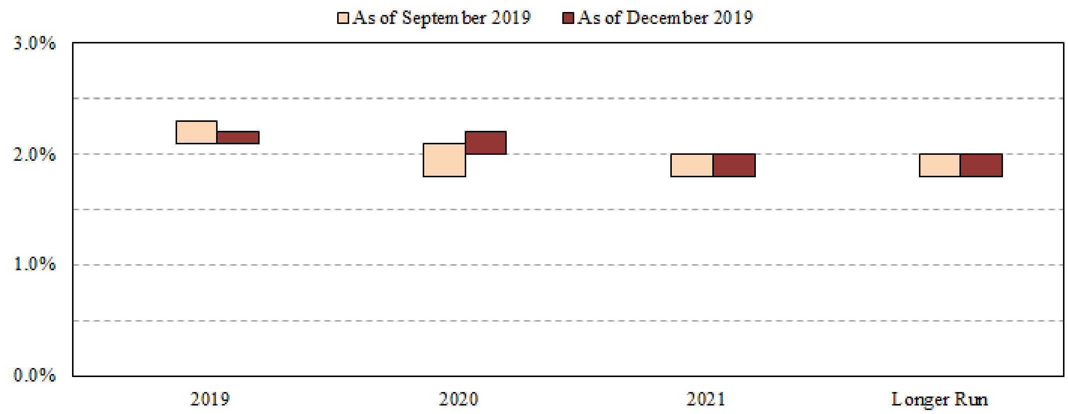
Trade

Trade concerns have appeared to subside following a volatile year. The long-term trade relationship between the U.S. and China appeared to be improving with the agreement of "phase one" of a new trade deal, along with the scheduled meetings to negotiate "phase two" of the deal. The deal addresses the following issues between the two countries; intellectual property, technology transfer, agriculture, financial services, currency, expanding trade, and dispute resolution.[7] The U.S. agreed to lower its tariff rate on select goods in exchange for an agreement by the Chinese to purchase more U.S. agricultural products. The expectation is that through each "phase" the U.S. will withdraw some of the tariffs it has placed on $360 billion worth of Chinese goods since the trade war started. In return, China is committing to purchase an additional $40 billion U.S. agricultural products per year and has the goal of increasing that to $50 billion annually. There is specific language in the agreement that allows the U.S. to reinstate some of the original tariffs if China fails to meet this threshold.[8] On December 13, the U.S. announced it would lower the tariff rate from 15 percent to 7.5 percent on $120 billion worth of Chinese goods and cancel planned tariffs on $160 billion worth of goods. In addition, the U.S.-Mexico-Canada trade agreement (USMCA) was approved by Congress in the fourth quarter, which eased concerns of potential auto tariffs from Mexico.

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 remained largely consistent from September to December. The projected growth rates for the longer run remain unchanged from June to September. The estimates for U.S. GDP growth are presented in the following figure.

U.S. GDP GROWTH ESTIMATES



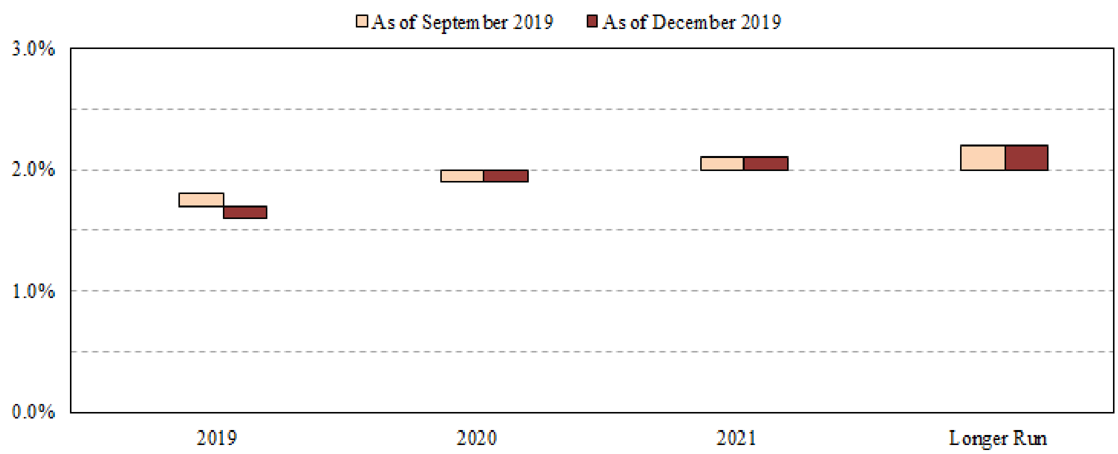
Source: Federal Reserve.

The U.S. Department of the Treasury's December 31, 2019, Treasury Statement of Receipts and Outlays of the United States Government states that the federal budget deficit for the first 3 months of fiscal year 2020 was $356.6 billion, in comparison to $318.9 billion for the same period in fiscal year 2019.[9] The CBO's August 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.[10] The CBO projects that decreases in these areas will result in slower growth for the next few years. Real GDP is projected to grow 2.3 percent in calendar year 2019, 2.1 percent in calendar year 2020, and 1.8 percent in calendar year 2021.[11] The CBO estimates excess demand to push inflation slightly above the Federal Reserve's 2.0 percent target and drive unemployment lower than the natural rate briefly, and then stabilize near their respective long-term rates in the following years. Interest rates are expected to gradually increase as the Federal Reserve has indicated rate hikes to the Federal Funds Rate are likely 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.[12] Real GDP is expected to grow, on average, at an annual rate of 1.8 percent in 2021, 1.7 percent from 2022 through 2023, and 1.8 percent from 2024–2029.[13]

Inflation, as measured by the core personal consumption expenditure (PCE), which excludes the effects of food and energy, is forecasted to be 1.9 percent in 2019, 2.2 percent in 2020, 2.1 percent in 2021, and average 2.0 percent per year in the longer run.[14] 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," January 31, 2020. <https://www.troweprice.com/personal-investing/planning-and-research/t-rowe-price-insights/markets/quarterly-market-review.html>.

7. U.S. Trade Representative, "Economic and Trade Agreement Between the United States of America and the People's Republic of China," January 15, 2020. <https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/US_China_Agreement_Fact_Sheet.pdf>.

8. Forbes, "Phase One U.S., China Trade Deal to be Signed This Week," December 30, 2019. <https://www.forbes.com/sites/sergeiklebnikov/2020/12/30/phase-one-us-china-trade-deal-to-be-signed-this-week-report/#5da733e3b1d7>.

9. U.S. Department of the Treasury, "Monthly Treasury Statement," December 31, 2019. <https://fiscal.treasury.gov/files/reports-statements/mts/mts1219.pdf>.

10. U.S. CBO, "An Update to the Budget and Economic Outlook: 2019 to 2029," August 2019. <https://www.cbo.gov/system/files/2019-08/55551-CBO-outlook-update_0.pdf>.

11. Ibid.

12. Ibid.

13. Ibid.

14. Ibid.