Economic Review - Third Quarter 2021

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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. The economy also affects the availability and price of inputs such as capital and labor. The prevailing economic conditions therefore directly affect the value of a business at a specific point in time. The 128-month economic expansion from June 2009 to February 2020 was the longest since the 1850s.[1] The COVID-19 global pandemic suddenly and severely affected economies and markets around the world, causing the U.S. economy to go into a recession from February 2020 to April 2020, which was the shortest recession in U.S. history.[2] Since returning to growth in April 2020, the U.S. economy has rapidly recovered, adding back over 17 million jobs in the last 17 months.

The Federal Open Market Committee (the "Committee") of the Federal Reserve held two meetings during the third quarter of 2021; one in July and one in September to discuss the additional measures being taken to support the economy, which include:

- Maintaining the target range for the federal funds rate at zero-to-0.25 percent.
- Continuing its purchases of Treasury and mortgage-backed securities (approximately $80 billion per month and approximately $40 billion per month, respectively), which combined with other supportive policies has brought the Federal Reserve's total assets to $8.4 trillion at the end of the third quarter of 2021; an increase of approximately $300 billion from $8.1 trillion as of June 30, 2021.
- The consideration of a moderation in the level of asset purchases in the coming months as labor conditions and the overall economy continue to improve.
- Conducting repurchase agreement operations to provide support to the short-term U.S. dollar funding markets.

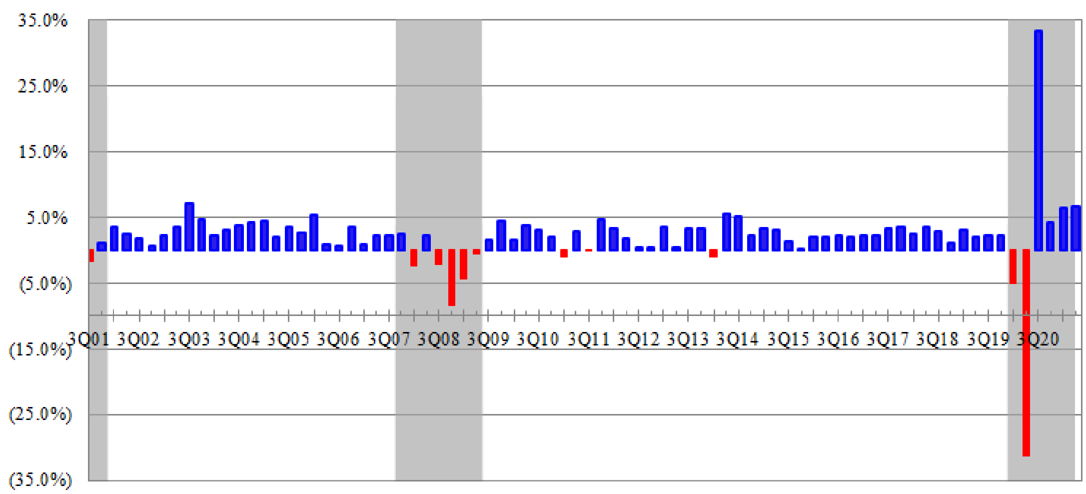
Gross Domestic Product

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 6.7 percent in the second quarter of 2021 as the recovery from the coronavirus pandemic continues. In 2020, GDP declined by 3.5 percent for the year, compared to a 2.3 percent increase in 2019.

The Federal Reserve publishes estimates of GDP growth. It projects a relatively strong recovery from the pandemic in 2021, with GDP growth of 5.9 percent. Thereafter, it projects GDP growth rates of 3.8 percent, 2.5 percent, and 2.0 percent in 2022, 2023, and 2024, respectively, before settling at 1.8 percent annual growth for the long-run. 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



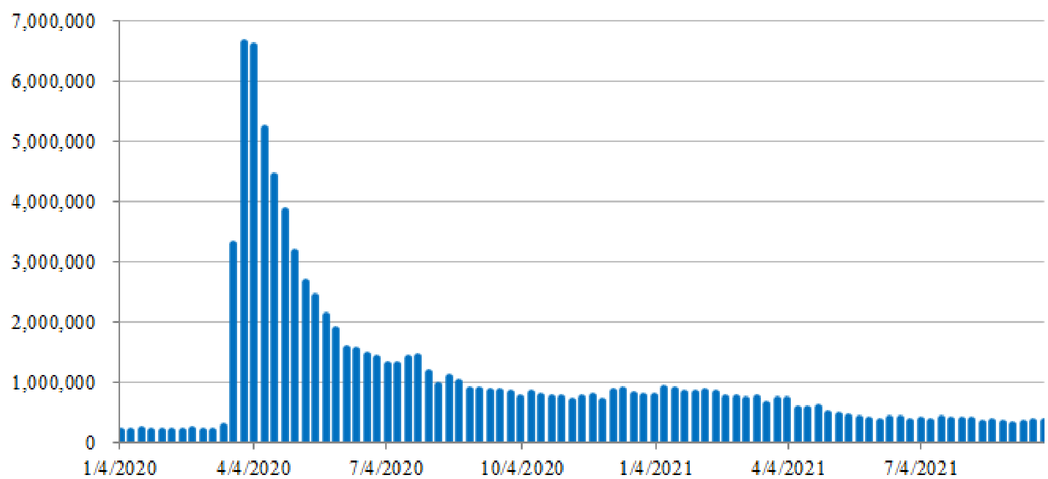
Sources: U.S. Bureau of Economic Analysis and National Bureau of Economic Research. GDP percent change is based on chained 2012 dollars.

Employment

From March 2010 (the end of the 2008–2009 recession) to February 2020, 23.2 million net non-farm jobs were created.[3] As recently as February 2020, the unemployment rate of 3.5 percent was near an all-time low. 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 at a 20-year low of 6.8 percent in December 2019.[4]

Beginning in March 2020, national, state, and local governments began instituting lockdowns that forced the closures of many businesses and restricted the free movement of citizens, and a wave of layoffs and furloughs began. Initial unemployment claims, which had averaged 218,000 per week in 2020 prior to the COVID-19 pandemic, spiked to a high of 6,648,000 for the week ending March 28, 2020. However, initial unemployment claims continued to trend lower, averaging 365,000 throughout the third quarter of 2021 compared to an average of 483,000 in the second quarter of 2021. Initial claims have subsided from the extreme levels in the first half of 2020 and are beginning to approach their pre-pandemic levels. Weekly initial unemployment claims since the beginning of 2020 are shown in the following figure.

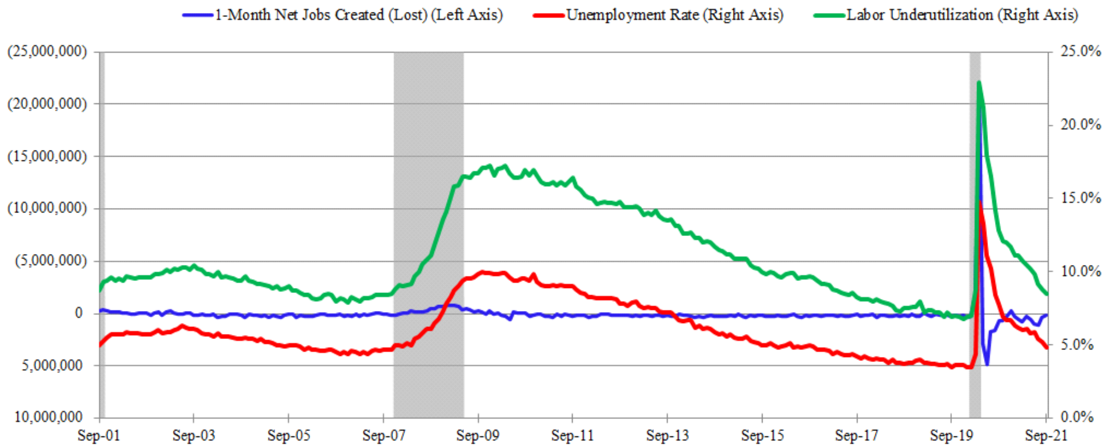
WEEKLY INITIAL UNEMPLOYMENT CLAIMS



Source: Federal Reserve Bank of St. Louis.

Unemployment and underemployment restrain economic growth as consumers are unable or hesitant to spend. The past 20 years of job creation, employment, and underemployment data are presented in the following figure.

MEASURES OF STRESS IN THE LABOR MARKET
Shaded Bar Indicates Recession



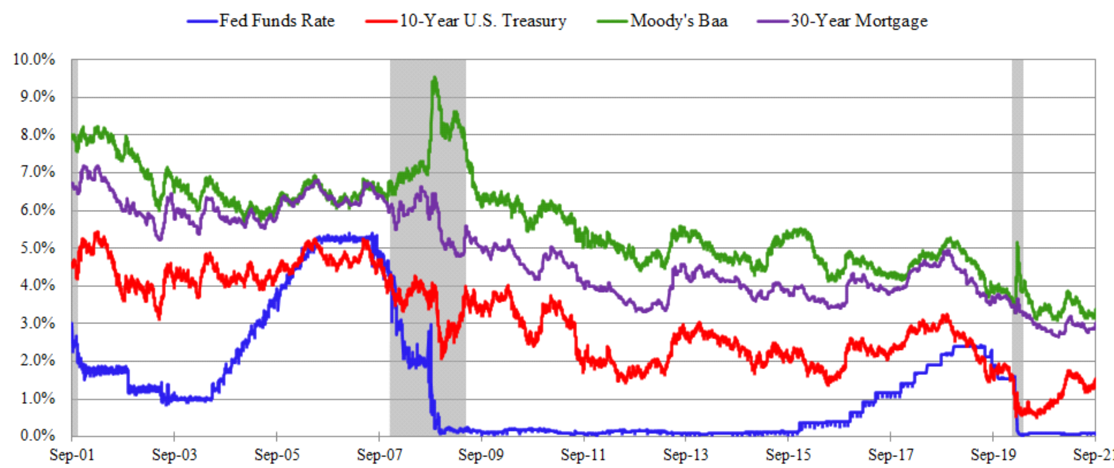
Sources: Department of Labor, Bureau of Labor Statistics, and National Bureau of Economic Research. Data represents non-farm payrolls.

While the labor market has continued to improve in recent quarters and is recovering from the pandemic, there is still a large number of unfilled job openings. As of August 2021, businesses reported that there was still over 10 million job openings available.[5] In addition, over 4 million workers reportedly quit their jobs in the month of August.[6] The higher the rate at which workers quit is generally viewed as a positive sign for the labor market, as workers will usually only quit their job if they believe they can find or have found a better job. The Committee believes that the large number of job openings and workers' willingness to quit their current jobs indicate that labor conditions are improving following the pandemic.

Interest Rates

Interest rates remained near their historical lows in the third quarter of 2021. The yield on the 10-year U.S. Treasury increased only 7 basis points in the third quarter despite data indicating that higher inflation may be more persistent than originally thought, which would put upward pressure on yields. The Moody's Baa rate increased just 5 basis points in the third quarter of 2021, as economic conditions remained generally accommodative. The 30-year fixed home mortgage rate was lower throughout most of the third quarter of 2021 before rising to just over 3 percent by the end of September, remaining near its historic 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

Other than the S&P 500, many major indices posted negative returns in the third quarter of 2021, moderating from their strong performance in the first half of the year. Volatility remained generally muted in the third quarter of 2021, as economic conditions and the threat of the pandemic continued to improve domestically. The S&P 500 was the lone index to post a positive return during the third quarter, causing it to be the best performing index year-to-date. However, despite slight decreases in the third quarter, other indices have still generated strong returns year-to-date, further signaling a general improvement in economic conditions. Total returns for U.S. stock indices are shown in the following figure.

TOTAL RETURNS OF MAJOR U.S. STOCK INDICES

Index	Third Quarter 2021	Year to Date
S&P 500	0.6%	15.9%
Dow Jones Industrial Average	(1.5%)	12.1%
NASDAQ Composite (1)	(0.4%)	12.1%
S&P MidCap 400	(1.8%)	15.5%
Russell 2000	(4.4%)	12.4%

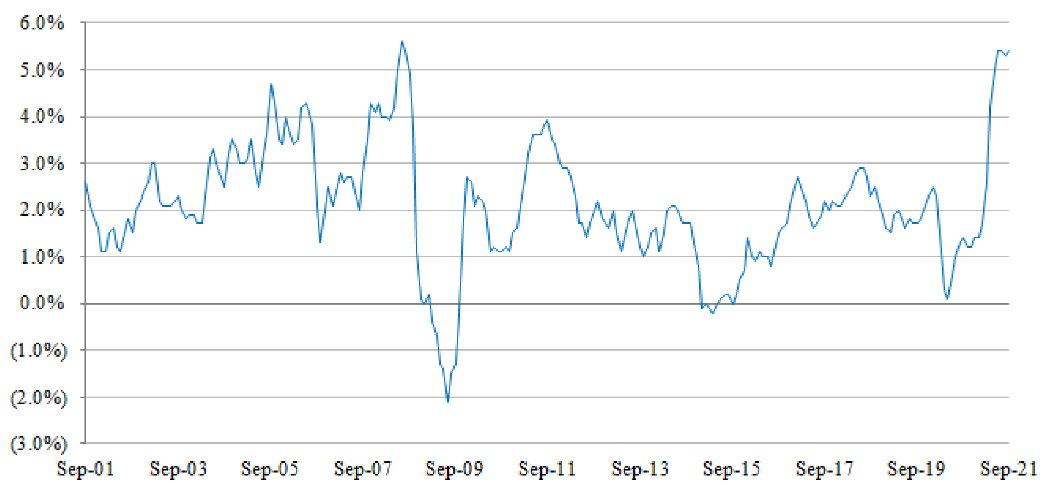
Note:
(1) Return represents principal only.

Inflation

Inflation continued to be one of the most prevalent topics surrounding the U.S. economy throughout the third quarter of 2021, as the threat of the coronavirus pandemic continues to subside. After initially describing elevated levels of inflation as transitory, many Federal Reserve governors, including Chairman Powell, have begun to temper expectations and indicated that inflation could be more of a long-term issue than originally thought. The consumer price index ("CPI") rose by 0.4 percent in the month of September alone, as well as 5.4 percent for the 12 months ending September 2021. This matches the 12-month increase experienced at the end of the second quarter of 2021. Core CPI, which excludes oil and food due to their volatility, increased by 4.0 percent over the same 12-month period, which was lower than the 4.5 percent increase reported at the end of the second quarter of 2021.[7] Among the items that experienced notable price increases during the month of September include oil (3.9 percent), new vehicles (1.3 percent), food (0.9 percent), and shelter (0.4 percent).

The annual change in the CPI for the past 20 years is shown in the following figure.

ANNUAL CHANGE IN THE CPI



Source: Bureau of Labor Statistics.

As a result of elevated levels of inflation in the past two quarters, inflation expectations are beginning to rise as well. The Federal Reserve monitors inflation expectations because if consumers and businesses anticipate an increase in wages and prices, they can adjust their behavior accordingly, making the expected inflation a reality. Every month, the Federal Reserve Bank of New York publishes expectations of inflation over the forward year. Prior to 2020, forward-looking inflation expectations generally remained between 2.5 percent and 3.0 percent since 2014. However, in 2021, inflation expectations have increased from 3.8 percent in January to 5.0 percent in August, before subsiding slightly to 4.7 percent in September.[8]

The Committee has reiterated that it will continue to tolerate moderate inflation above its long-term goal of 2 percent in the short-term, as inflation in the decade prior to the pandemic was generally below its long-term target of 2 percent. The Committee will accept short-term inflation as long as it supports the goal of achieving maximum employment, and longer term inflation expectations do not rise to unreasonable levels.

The Federal Reserve publishes estimates of personal consumption expenditures ("PCE") inflation and Core PCE inflation. It projects modest inflation in 2021, with PCE inflation of 4.2 percent and Core PCE inflation of 3.7 percent. In the years following, it projects PCE and Core PCE inflation of just over 2 percent annually, supporting its stance that the current inflationary environment will not be long-term.

Coronavirus Pandemic and Government Response

- The coronavirus continued to impact the United States and the global economy throughout the third quarter of 2021, although the National Bureau of Economic Research officially declared that the United States recession that began in February 2020 reached its low point in April 2020 and the economy has been recovering since.

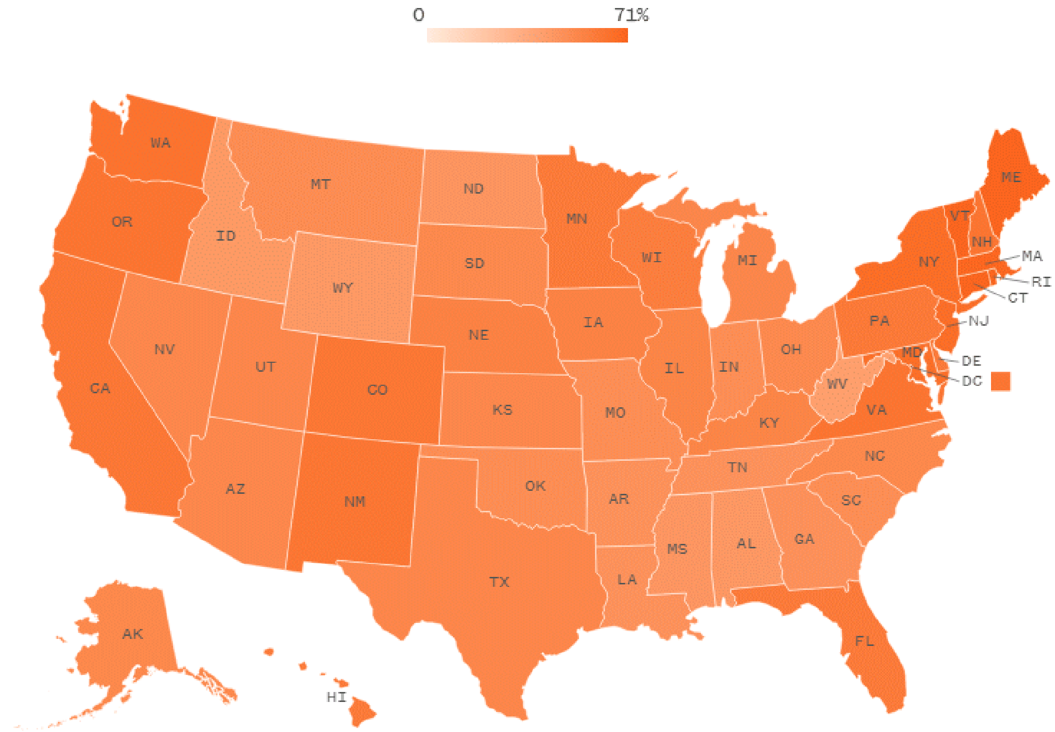
- As of September 26, 2021, COVID-19 confirmed cases have surpassed 231 million people and caused over 4.7 million deaths globally.[9]

- Back in May 2021, the World Health Organization identified "Delta" as a new coronavirus variant of concern, due to its ease of transmissibility. The Delta variant has begun to wane in the United States as a larger percentage of the country is either vaccinated or those who have contracted the virus have built up a natural immunity.

- Globally, the coronavirus, and specifically the Delta variant, have continued to spread more aggressively throughout poorer countries that have less robust healthcare systems.[10]

- The percentage of Americans by state that are fully vaccinated as of September 30, 2021, is shown in the following figure.

PERCENTAGE THAT IS FULLY VACCINATED



Source: NBC News.

Endnotes:

1. National Bureau of Economic Research. <https://www.nber.org/research/data/us-business-cycle-expansions-and-contractions>.

2. Ibid.

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. "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.

5. Bureau of Labor Statistics, "Job Openings and Labor Turnover - August 2021," October 12, 2021. <https://www.bls.gov/news.release/pdf/jolts.pdf>.

6. Ibid.

7. Bureau of Labor Statistics, "Consumer Price Index - September 2021," October 13, 2021. <https://www.bls.gov/cpi/>.

8. Federal Reserve Bank of New York, "Survey of Consumer Expectations". <https://www.newyorkfed.org/microeconomics/sce#/hpuncert-1>.

9. World Health Organization, "COVID-19 Weekly Epidemiological Update," September 28, 2021. <https://www.who.int/publications/m/item/weekly-epidemiological-update-on-covid-19---28-september-2021>.

10. Ibid.