Economic Review - Fourth Quarter 2021

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Summary

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The Federal Open Market Committee (the "Committee") of the Federal Reserve held two meetings during the fourth quarter of 2021; one in November and one in December 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 for the time being; but signaling that rate hikes will likely be necessary throughout 2022 in light of prolonged and excessive inflation beyond its 2.0 percent target.

- Increasing the rate at which it will reduce the monthly purchases of Treasury and mortgage-backed securities from $10 billion and $5 billion, respectively; to $20 billion and $10 billion, respectively, beginning in January 2022. This policy, along with the Committee's other supportive policies over the past two years, has brought the Federal Reserve's total assets to $8.76 trillion at the end of the fourth quarter of 2021; an increase of approximately $300 billion from $8.45 trillion as of September 30, 2021.

- The consideration of additional moderations in the level of asset purchases in the coming months as labor conditions improve and inflation becomes a bigger hindrance to the ongoing economic recovery.

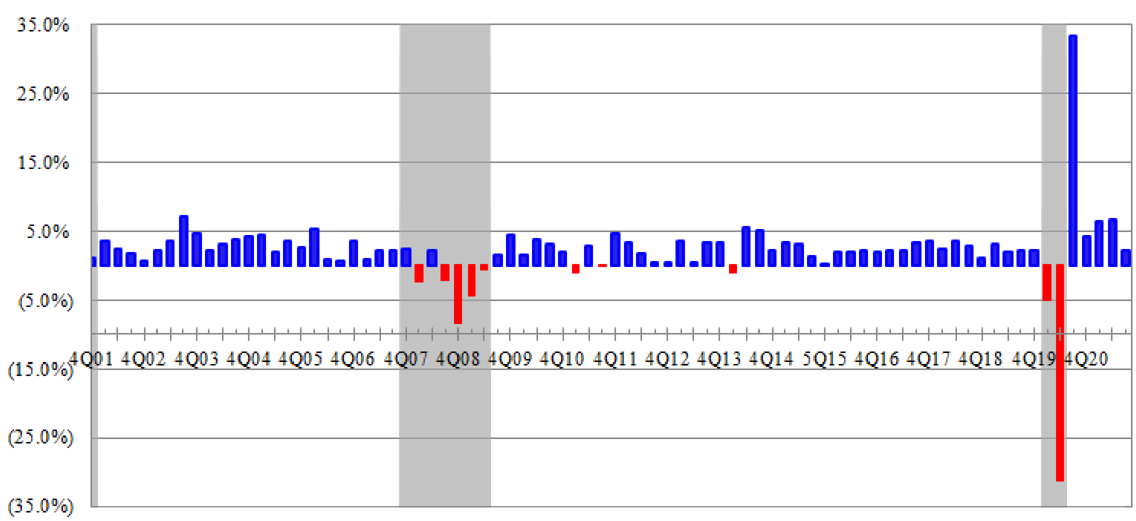
- Conducting repurchase agreement operations to provide support to the short-term U.S. dollar funding markets.

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 capital located in the United States — increased at an annual rate of 2.3 percent in the third quarter of 2021, as the economic recovery from the coronavirus pandemic continues to be dependent on the spread and severity of the virus. 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 5.5 percent. Thereafter, it projects GDP growth rates of 4.0 percent, 2.2 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



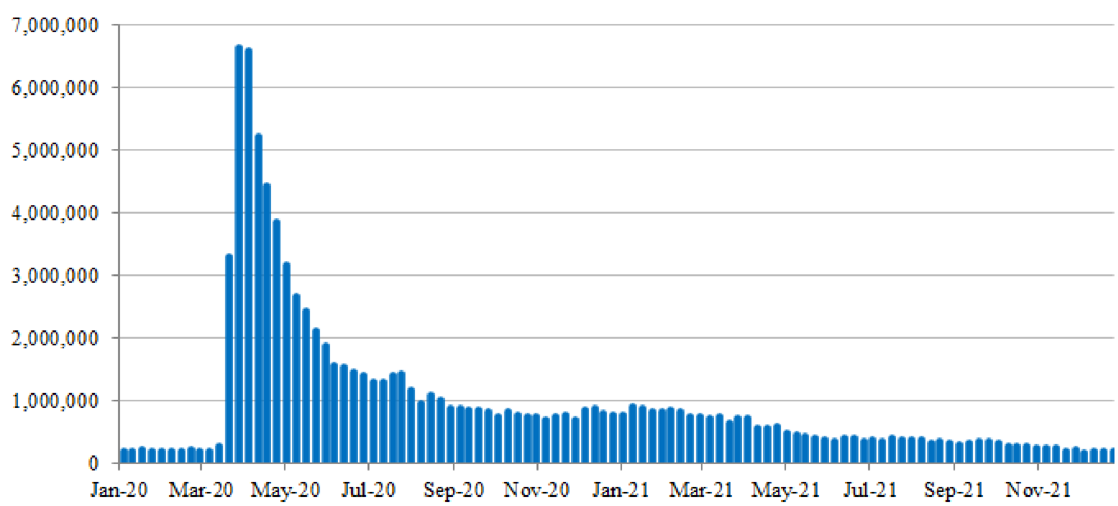
Sources: U.S. Bureau of Economic Analysis and National Bureau of Economic Research. GDP percent change is based on chained 2012 dollars.

Employment

From March 2010 (the end of the 2008–2009 recession) to February 2020, 23.2 million net non-farm jobs were created.[3] At the end of the fourth quarter of 2021, the unemployment rate was at a considerably low level of 3.9 percent. 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 also near a historical low of 7.3 percent in December 2021.[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 248,000 throughout the fourth quarter of 2021 compared to an average of 365,000 in the third quarter of 2021. In addition, initial claims for the week ending December 4, 2021, were 188,000, its lowest point since September 1969. Initial claims have subsided from the extreme levels in the first half of 2020 and have started to become in-line with their pre-pandemic levels. Weekly initial unemployment claims since the beginning of 2020 are shown in the following figure.

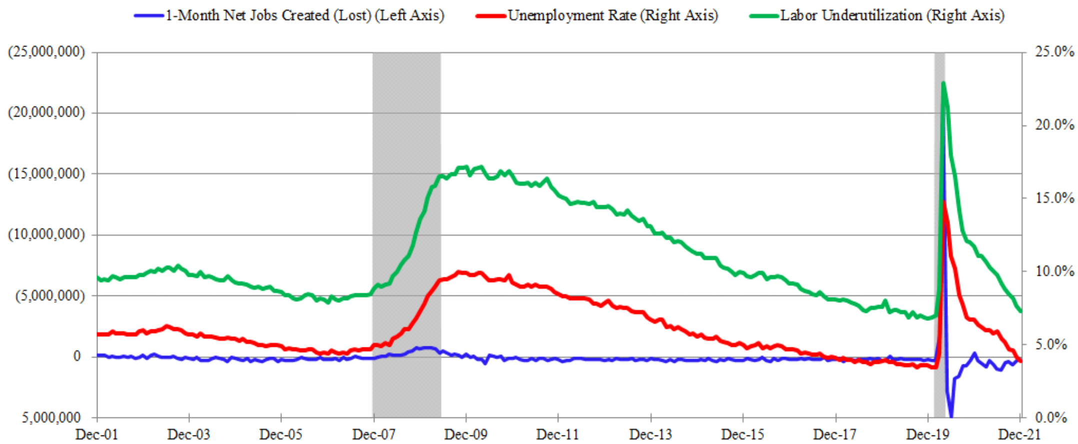
WEEKLY INITIAL UNEMPLOYMENT CLAIMS



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



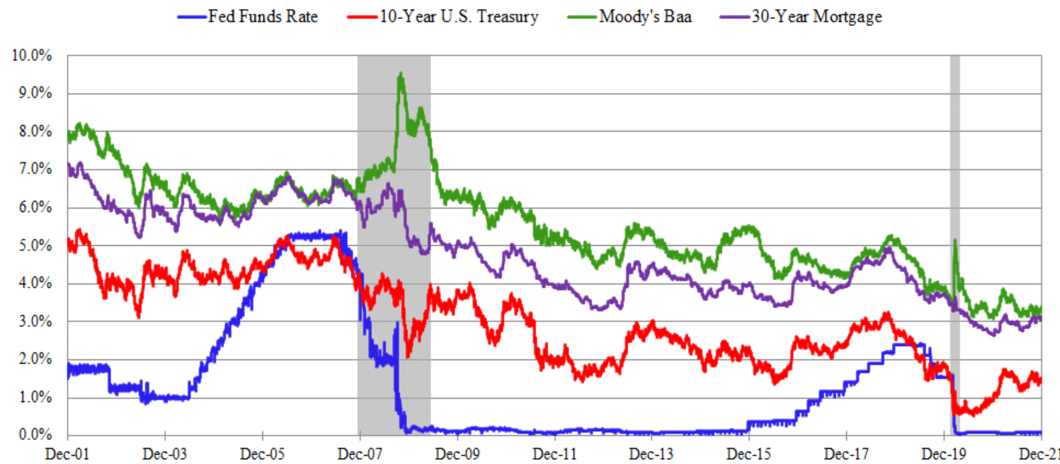
Sources: Department of Labor, Bureau of Labor Statistics, and National Bureau of Economic Research. Data represents non-farm payrolls.

While the labor market has continued to improve in recent quarters and is recovering well from the pandemic, there is still a large number of unfilled job openings. As of November 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 November, which has been near all-time highs in the previous months.[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 generally continuing to improve.

Interest Rates

Interest rates remained near their historical lows in the fourth quarter of 2021. The yield on the 10-year U.S. Treasury initially increased during the month of October, but quickly reversed course in November and December as the threat of the new coronavirus "Omicron" variant created additional uncertainty and prompted investors to pursue safer assets such as U.S. Treasuries. Ultimately, the yield on the 10-year Treasury remained unchanged from the end of September to the end of the December. The Moody's Baa rate remained unchanged as well by the end of the fourth quarter following modest fluctuations. Overall business conditions remained accommodative, however, this was largely counteracted by the looming uncertainty of the Omicron variant. The 30-year fixed home mortgage rate continued its gradual climb from historic lows over the past two quarters. Mortgage rates began to increase in late July of 2021 as it became more evident the Committee will likely begin raising interest rates in 2022 to address the elevated levels of inflation beyond their 2.0 percent target. 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

All the major indices posted positive returns in the fourth quarter of 2021, following underwhelming returns during the third quarter. Volatility, which had been effectively subdued in the third quarter, spiked in late November as fears surrounding the Omicron variant alarmed investors. Volatility began to level off towards the end of the fourth quarter of 2021 as initial data suggested that the Omicron variant, while extremely contagious, appears to be less severe than previous variants.

The S&P 500 was the best performing index in the fourth quarter and for 2021 as a whole. However, all the other indices, fueled by solid fourth quarter returns, ended the year with strong returns overall as well, further signaling a general improvement in economic conditions throughout the fourth quarter of 2021. Total returns for U.S. stock indices are shown in the following figure.

TOTAL RETURNS OF MAJOR U.S. STOCK INDICES

Index	Fourth Quarter 2021	Year to Date
S&P 500	11.0%	28.7%
Dow Jones Industrial Average	7.9%	20.9%
NASDAQ Composite (1)	8.3%	21.4%
S&P MidCap 400	8.0%	24.8%
Russell 2000	2.1%	14.8%

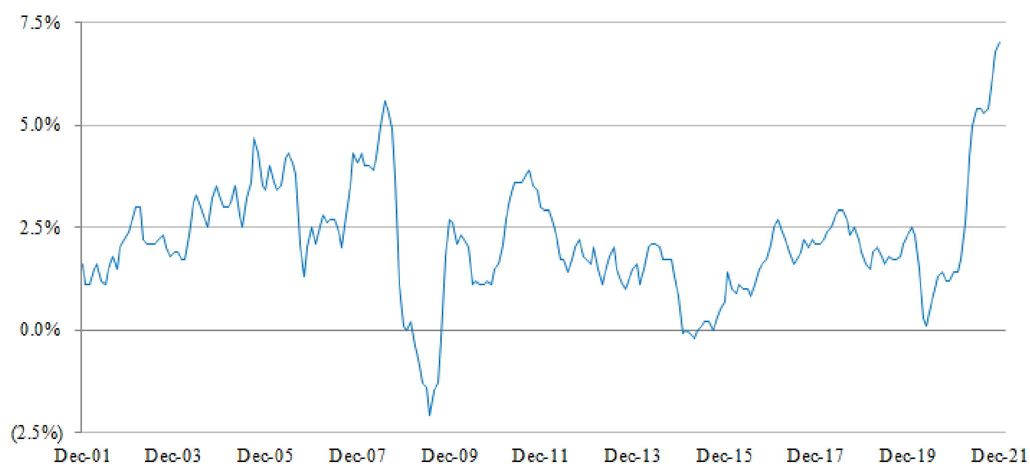
Note:
(1) Return represents principal only.

Inflation[7]

Inflation continued to be one of the most prevalent topics surrounding the U.S. economy throughout the fourth quarter of 2021, as the coronavirus pandemic continues to disrupt global supply chains and consumer and producer expectations. Chairman Powell has reiterated that the Committee will utilize the appropriate tools to fulfill its dual mandate as directed by Congress, which includes stable prices (defined as 2.0 percent annual inflation). The consumer price index ("CPI") rose by 0.5 percent in the month of December alone, as well as 7.0 percent for the 12 months ending December 2021, which is the highest 12-month increase since 1982. Core CPI, which excludes oil and food due to their volatility, increased by 5.5 percent over the same 12-month period, which is the largest increase since 1991. Among the items that experienced notable price increases during the month of December include food (0.5 percent), new and used vehicles (1.0 percent and 3.5 percent, respectively), and apparel (1.7 percent). After increasing by 4.8 percent and 3.5 percent in October and November of 2021, respectively, energy prices declined by 0.4 percent in December as gasoline and natural gas prices decreased.

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 the elevated levels of inflation that began in the second quarter of 2021 and have continued to rise throughout the end of the year, 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, one-year forward-looking inflation expectations generally remained between 2.5 percent and 3.0 percent since 2014. However, in 2021, inflation expectations have increased from 3.0 percent in January to 6.0 percent in December.[8]

The Committee has continued to adjust its stance as the outlook of inflation becomes more severe than the Committee initially believed. However, the Committee has recently confirmed its intent to adjust its policies accordingly for the purpose of achieving stable prices. At its December meeting, the members of the Committee provided their outlook of the federal funds rate in the coming years. All but one member has signaled that at least two rate increases will be necessary in 2022, followed by subsequent rate increases throughout 2023 and 2024 to address inflation.[9]

The Federal Reserve publishes estimates of personal consumption expenditures ("PCE") inflation and Core PCE inflation. It projects high inflation in 2021, with PCE inflation of 5.3 percent and Core PCE inflation of 4.4 percent. However, in the years to follow, the Federal Reserve expects inflation to retreat to more moderate levels, projecting PCE and Core PCE inflation of just over 2 percent annually, supporting its belief that adjustments in the Committee's policy will not allow the inflationary environment to exist long-term.

Coronavirus Pandemic and Government Response

- The coronavirus continued to impact the United States and the global economy throughout the fourth quarter of 2021, specifically due to the emergence of the highly contagious Omicron variant around the world.

- The Omicron variant became the dominant variant in the United States during the fourth quarter after first emerging in South Africa and parts of Europe. However, early data has indicated there is a reduced risk for death or severe illness when compared to the Delta variant, which should help mitigate the overall economic impact.

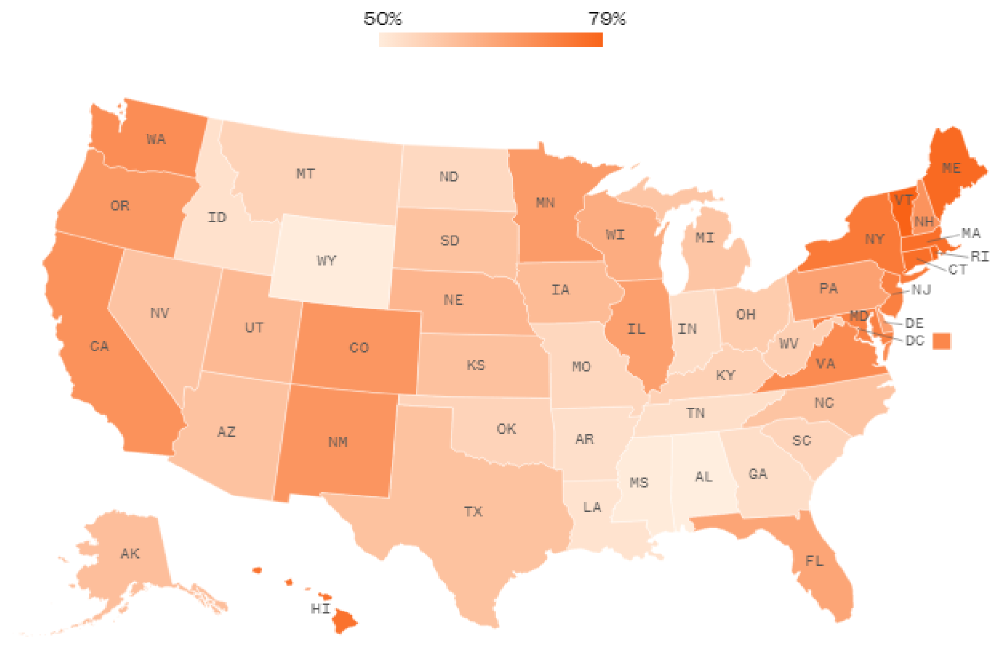
- The Omicron variant is expected to sweep through the United States very quickly due to its ease of transmission, as confirmed cases have begun to increase towards the end of the fourth quarter.

- As of December 26, 2021, COVID-19 confirmed cases have surpassed 278 million people and caused over 5.3 million deaths globally. [10]

- Consistent with the initial onset of the coronavirus and the subsequent variants, the coronavirus has continued to spread more aggressively throughout poorer countries that have less robust healthcare systems.[11]

- The percentage of Americans by state that are fully vaccinated as of December 31, 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 - November 2021," January 4, 2022. <https://www.bls.gov/news.release/archives/jolts_01042022.pdf>.

6. Ibid.

7. Bureau of Labor Statistics, "Consumer Price Index - December 2021," January 12, 2022. <https://www.bls.gov/news.release/pdf/cpi.pdf/>.

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

9. Board of Governors of the Federal Reserve System, "Summary of Economic Projections," December 15, 2021. <https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20211215.pdf>.

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

11. Ibid.