Economic Review - First 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.

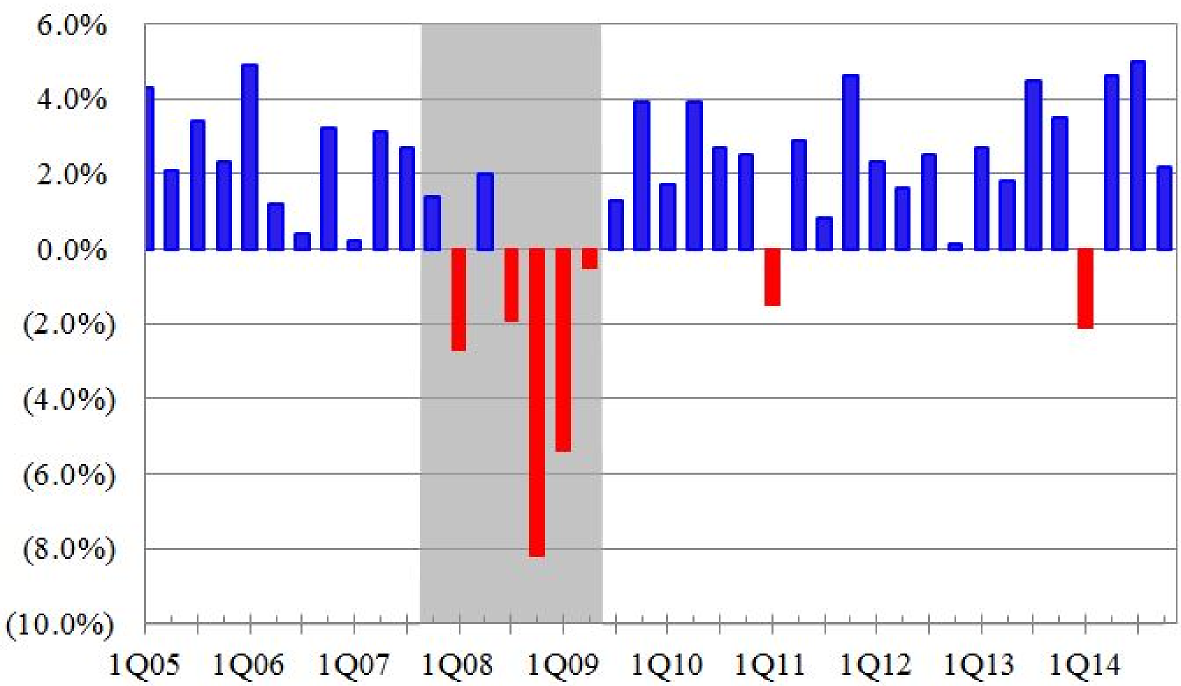
Summary

Following the March 17–18, 2015, 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 2015. Labor market conditions continue to improve and business investments are advancing, but the recovery in the housing sector remained slow as growth in household spending declined and exports declined due to weak demand for agricultural goods and lower petroleum prices.

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 2.2 percent in the fourth quarter of 2014. Quarterly GDP data for the preceding ten years is shown in the following figure.

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

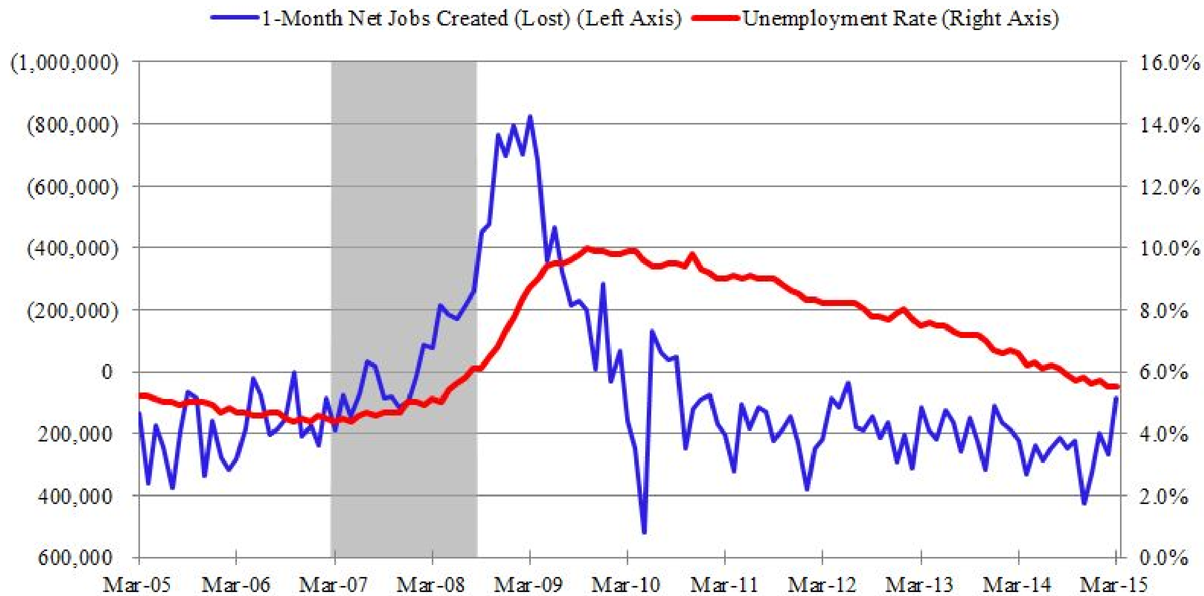


Sources: U.S. Bureau of Economic Analysis and National Bureau of Economic Research.
GDP percent change is based on chained 2009 dollars.

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 61 consecutive months from March 2010 to March 2015, 11.5 million non-farm jobs (net) were created.[1] The unemployment rate peaked at 10.0 percent in October 2009 and has abated to 5.5 percent as of March 2015.[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 10.9 percent as of March 2015.[3] Underemployment tempers economic growth as consumers are unable or hesitant to spend. The past ten years of employment data are presented in the following figure.

MEASURES OF STRESS IN THE LABOR MARKET
Shaded Bar Indicates Recession



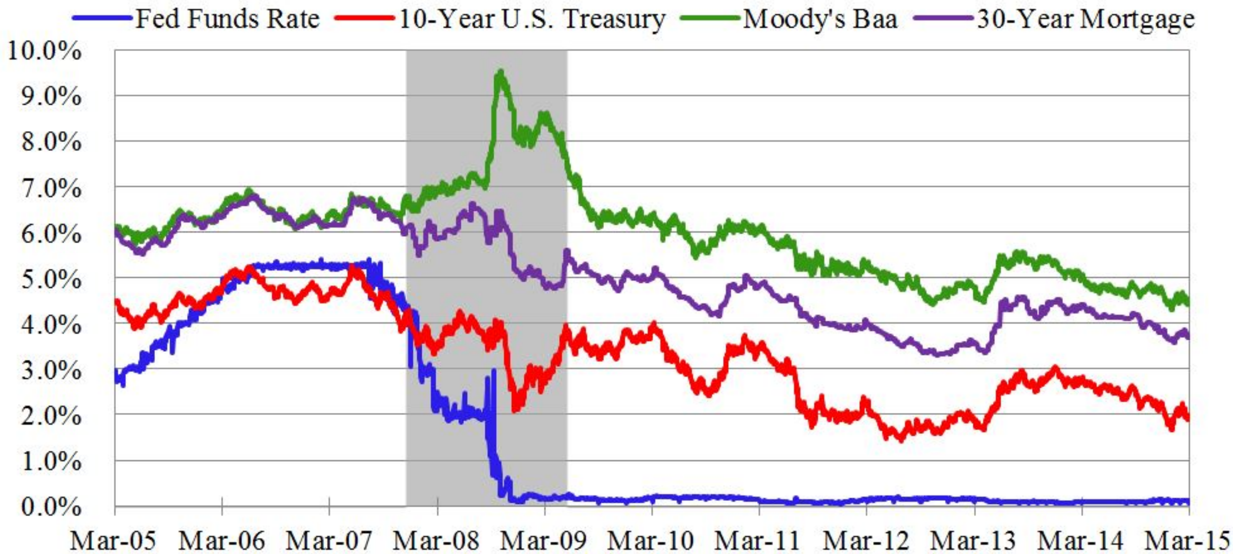
Sources: Department of Labor, Bureau of Labor Statistics, and National Bureau of Economic Research. Data represents non-farm payrolls.

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 17–18, 2015, meeting the Committee kept the target federal funds rate at zero to 0.25 percent. The Committee anticipates that it will be appropriate to raise the target range for the federal funds rate when it has seen further improvement in the labor market and is reasonably confident that inflation will move back to its 2 percent objective over the medium term. Many economists expect at least one rate increase before the end of 2015. The Committee will continue its existing policy of reinvesting proceeds from maturing bonds.

United States financial markets remained supportive of economic growth and employment in the first quarter of 2015. Corporate bond spreads narrowed and 30-year mortgage rates also decreased during the fourth quarter. Housing sector activity remains slow despite decreased mortgage rates. The issuance of commercial and industrial loans, automobile loans, and student loans continued to expand robustly in the first quarter of 2015. Ten 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 reached all-time highs in the middle of the first quarter before declining to a return of 0.95 percent including dividends. The Dow Jones Industrial Average (DJIA) stock index declined slightly; however, its total return including dividends was positive for the quarter. The NASDAQ Composite stock index increased over the first quarter of 2015, exceeding 5,000 for the first time in 15 years. Small-cap stocks performed better, in part due to lower exposure to foreign markets. The strong U.S. dollar, due to economic weakness in Europe and Asia, has challenged U.S. firms with significant international operations. The total returns for certain major U.S. stock indices during the first quarter of 2015 are shown in the following figure.

TOTAL RETURN OF MAJOR U.S. STOCK INDICES

Index	**Total Return**
S&P 500	0.95%
DJIA	0.33%
NASDAQ Composite	3.48%
S&P MidCap 400	5.31%
Russell 2000	4.32%

Despite the S&P 500 hitting a record high, the number of initial public offerings ("IPOs") in the first quarter of 2015 was the lowest since the first quarter of 2013, and the total proceeds from IPOs was the smallest since the third quarter of 2011. There were 34 IPOs in the first quarter of 2015, a decrease from 68 IPOs in the first quarter of 2014. Healthcare IPOs were the largest category, accounting for 47 percent of all IPOs.[4] IPO proceeds totaled $5.4 billion in the first quarter of 2015, a 49 percent decrease from the first quarter of 2014. The broad decline occurred across most sectors, particularly technology, energy, and from both private equity and venture-capital backed companies.

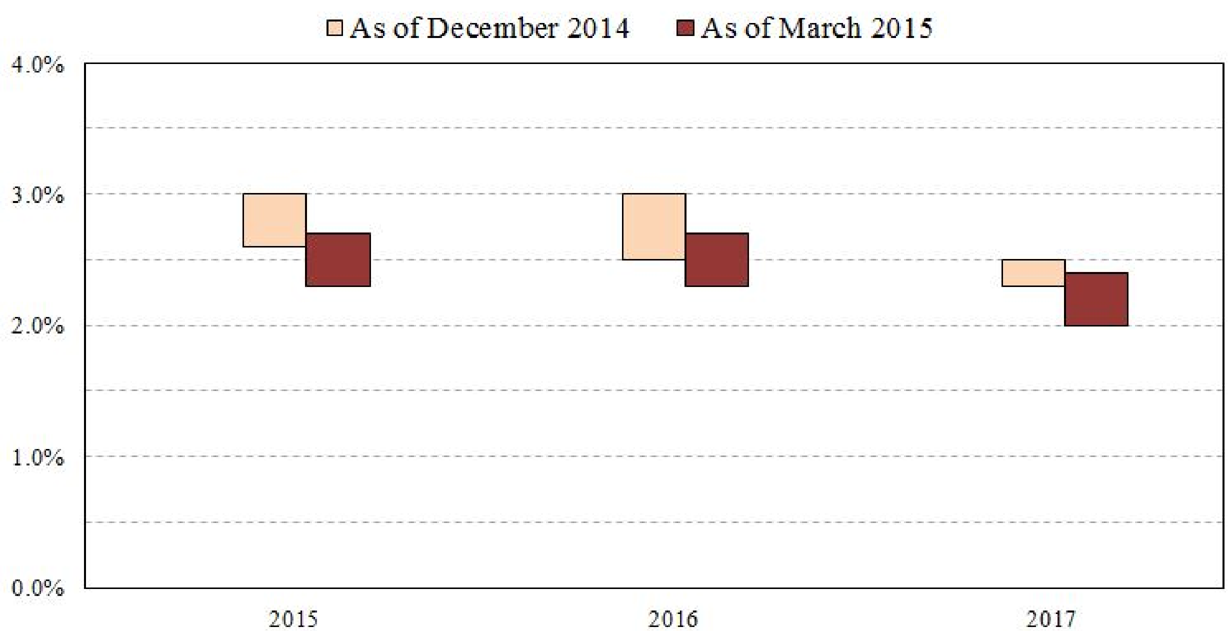
The European sovereign debt crisis that began in earnest with Greece in 2010 and the subsequent recession has abated, although its effects continue to adversely affect local economies and employment levels. Although the proximate cause was the 2007–2009 financial crisis, a combination of persistent structural deficits, trade imbalances, and real estate bubbles in the decade prior resulted in a series of European nations requiring substantial financial bailouts. A "troika" of international lenders consisting of the European Union, the European Central Bank, and the International Monetary Fund has provided extraordinary financial support to five of seventeen euro area countries. The unemployment rate in the European Union decreased from the May 2013 record-high of 11.0 percent to 9.7 percent in March 2015.

In January 2015, the citizens of Greece elected a government led by the anti-austerity Syriza Party, which sought to change the terms of Greece's second European bailout from February 2012. Greece's creditors, including the troika, have held firm in their demands for tax and spending reform in Greece; however, in February 2015, the two sides agreed to extend the bailout, which was due to expire on February 28, 2015, until June 30, 2015. Under the terms of the extension, the Greek government agreed to submit and carry out reforms approved by the troika. The bailout funds can only be released upon review of the bailout provisions, which will not happen before the end of April 2015. It is uncertain if the Greek government will be able to fulfill its obligations under the current terms of the extension. A Greek exit from the Eurozone could have serious repercussions across financial markets.

Outlook

Various statistical reporting agencies provide estimates of the U.S. economy's near-term and longer-term growth rates. In March, the Federal Reserve lowered its projected growth rates for the U.S. economy between 2015 and 2017 from its December forecast due to the further appreciation of the U.S. dollar and recent weakness in spending and production data. 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 Treasury's March 2015 Monthly Treasury Statement of Receipts and Outlays of the United States Government states that the federal budget deficit for fiscal year 2014 was $483 billion, a decrease of 29.0 percent from $680 billion in fiscal year 2013. For the first six months of fiscal year 2015, the federal budget deficit was $439 billion.[5] The CBO's March 2015 report projects that further growth in housing construction and business investment will raise output and employment and, therefore, increase consumer spending.[6] Real GDP is projected to grow 2.9 percent in fiscal years 2015 and 2016, and 2.5 percent in 2017. By the second half of 2017, the CBO estimates that the gap between actual GDP and the economy's potential GDP will be eliminated.[7] Real GDP is expected to grow, on average, at an annual rate of 2.1 percent from 2018 through 2024.[8]

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, 2.2 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.[9] 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. Renaissance Capital LLC, "U.S. IPO Market 1Q 2015 Quarterly Review ," March 2015, <http://www.renaissancecapital.com/news/renaissance-capitals-1q-2015-us-ipo-market-review-25822.html>.

5. U.S. Department of Treasury, "March 2015 Monthly Treasury Statement of Receipts and Outlays of the United States Government," April 2015. <https://www.fiscal.treasury.gov/fsreports/rpt/mthTreasStmt/mts0315.pdf>.

6. U.S. CBO, "An Update to the Budget and Economic Outlook: 2015–2025," March 2015. <http://www.cbo.gov/sites/default/files/cbofiles/attachments/49973-UpdatedBudgetProjections.pdf>.

7. Ibid.

8. Ibid.

9. Ibid.