APPRAISAL ECONOMICS
Independent Valuation Experts

Economic Review - Second 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.

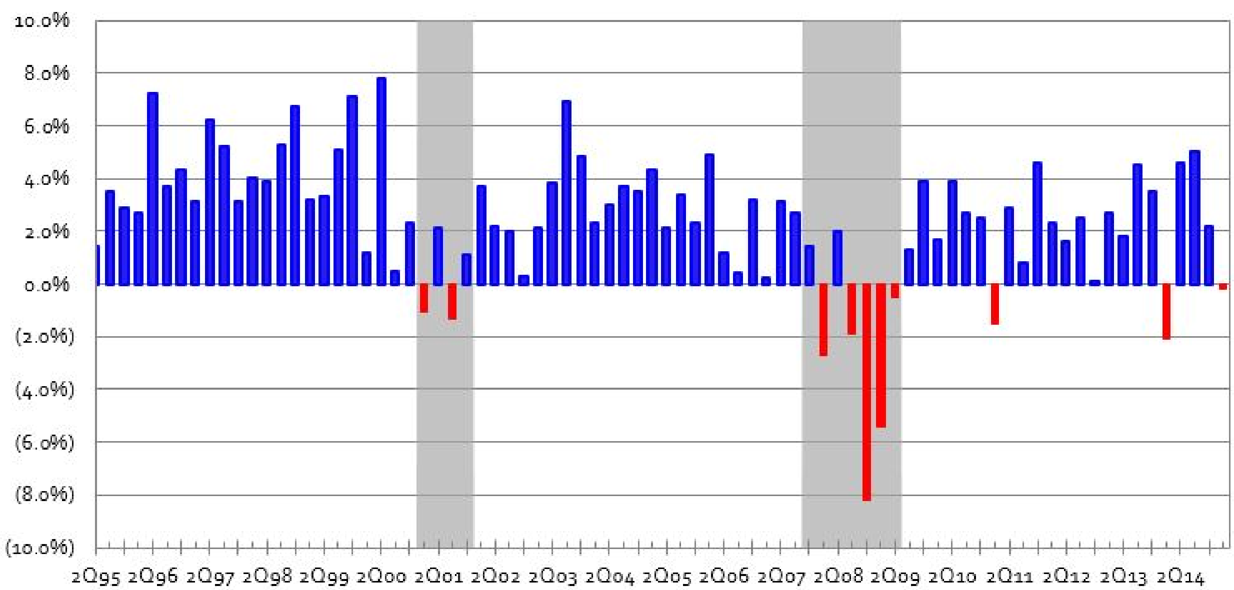
Summary

Following the June 16–17, 2015, meeting of the Federal Open Market Committee (the "Committee") of the Federal Reserve, the Committee issued a statement that economic activity expanded moderately in the second quarter of 2015 after softening in the first quarter of 2015. Labor market conditions continue to improve although business investments have slowed as the output of the manufacturing and mining sectors have fallen. Household spending has improved at a modest pace as real disposable income and households' net worth have increased; however, the recovery in the housing sector remains slow.

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 — decreased at an annual rate of 0.2 percent in the first quarter of 2015. 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



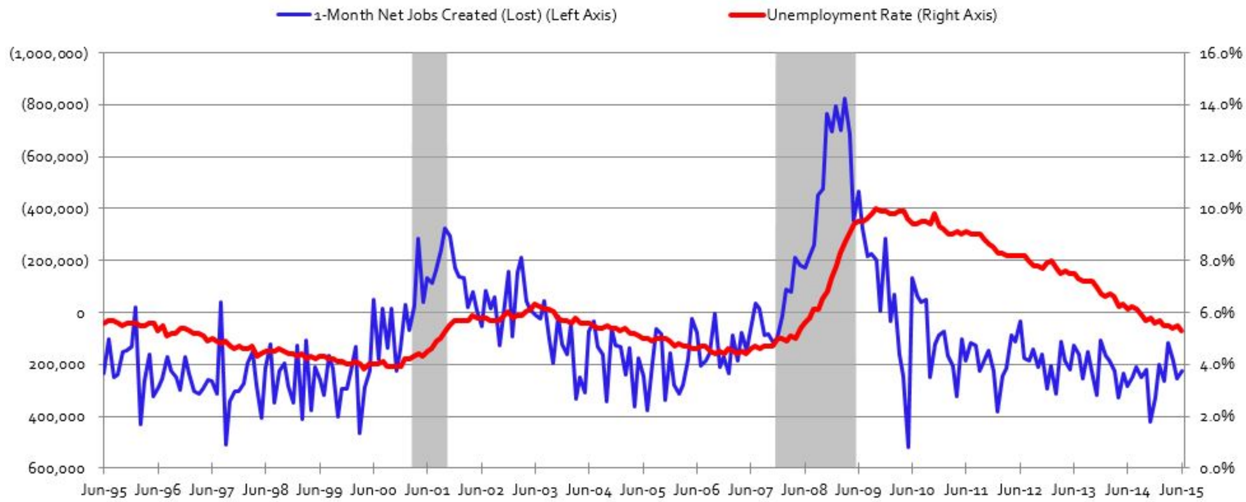
Sources: U.S. Bureau of Economic Analysis and National Bureau of Economic Research.
GDP percent change is based on chained 2009 dollars.

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 64 consecutive months from March 2010 to June 2015, 12.2 million non-farm jobs (net) were created.[1] The unemployment rate peaked at 10.0 percent in October 2009 and has abated to 5.3 percent as of June 2015, the lowest unemployment rate since May 2008.[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 10.5 percent as of June 2015.[3] Underemployment tempers 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 June 16–17, 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, possibly as soon as September. 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 second quarter of 2015 despite the widening of corporate bond spreads and increase in 30-year mortgage rates during the first quarter. The issuance of commercial and industrial loans, automobile loans, and student loans continued to expand robustly in the second quarter of 2015. 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.

Current Events

The Standard and Poor's (S&P) 500 and the Dow Jones Industrial Average (DJIA) stock indices were relatively flat during the second quarter of 2015. Despite corporate earnings growth and enthusiasm about an accelerating U.S. economy, there was great uncertainty among investors regarding the ongoing Greek debt crisis. Utilities and industrials stocks underperformed, while healthcare and consumer discretionary stocks outperformed. The NASDAQ Composite stock index increased to 5,160 in the second quarter of 2015, exceeding the previous record of 5,049 reached in March 2000. Small-cap stocks continued to increase this quarter; mid-caps were the poorest performers among the major benchmarks. The total returns for U.S. stock indices during the second quarter of 2015 are shown in the following figure.

TOTAL RETURNS OF MAJOR U.S. STOCK INDICES IN 2Q15

Index	Total Return
S&P 500	0.28%
DJIA	(0.29%)
NASDAQ Composite	1.75%
S&P MidCap 400	(1.06%)
Russell 2000	0.42%

The number of initial public offerings (IPOs) and the amount of capital raised more than doubled during the second quarter of 2015 compared to the first quarter. There were 70 IPOs in the second quarter of 2015, a decrease from 83 IPOs in the second quarter of 2014, a 14-year record. Healthcare IPOs were the largest category, accounting for 30 IPOs, or 43 percent of all IPOs.[4] IPO proceeds totaled $12.7 billion in the second quarter of 2015, a 39 percent decrease from the second quarter of 2014; however, IPO proceeds exceeded the first quarter of 2015 by 131 percent due to a broad increase across most sectors, particularly healthcare, technology, consumer, 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 9.6 percent in May 2015.

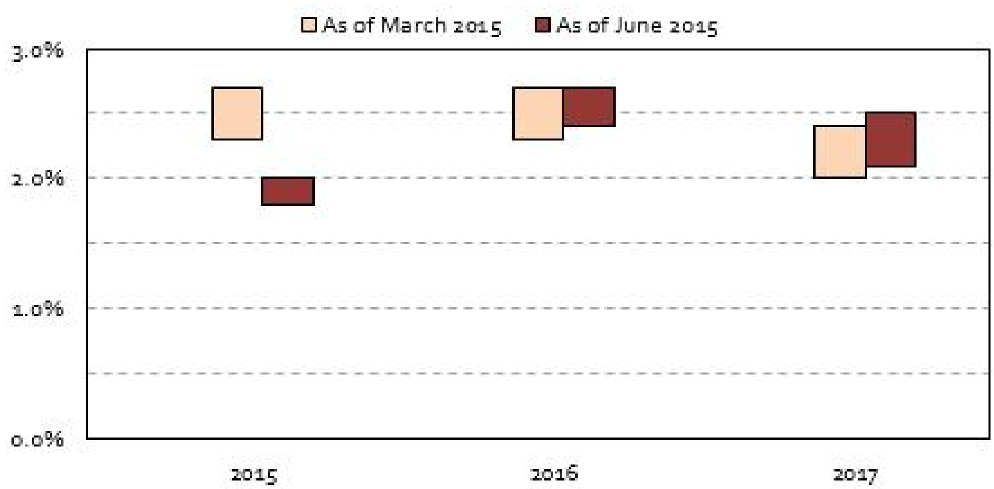
In January 2015, Greek citizens elected a government led by the anti-austerity Syriza Party, which sought to renegotiate the terms of Greece's second European bailout from February 2012. Greece's creditors, including the troika, have held firm in their demands for tax and spending reform in Greece; however, 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. Extensive negotiations have been held between Greece and the troika since the February 2015 agreement; however, on June 26, 2015, negotiations for a revised financial arrangement broke off as Greek authorities put forward a proposal to call for a referendum to be held on July 5, 2015. On June 30, 2015, Greece defaulted on a €1.5 billion payment to the International Monetary Fund, rejecting an attempt to extend its bailout program with its creditors. It is uncertain if the Greek government will be able to reach a deal for a third bailout package with the troika in the near future, as the troika demands that certain conditions are met to stabilize Greek finances. A Greek exit from the Eurozone could have serious repercussions across financial markets.

On June 29, 2015, Governor Alejandro García Padilla of Puerto Rico announced that Puerto Rico would be unable to pay its roughly $72 billion of debt to various debtholders. As a commonwealth of the United States, Puerto Rico is unable to file for Chapter 9, Title 11 bankruptcy under the United States Bankruptcy Code, which is available exclusively to U.S. municipalities, to restructure its debts. Puerto Rico is instead seeking significant concessions from its creditors, which could include deferring some debt payments for as long as five years. As of the end of second quarter of 2015, the economic impact of the Puerto Rican debt crisis remains uncertain.

Outlook

Various statistical reporting agencies provide estimates of the U.S. economy's near-term and longer-term growth rates. In June, the Federal Reserve lowered its projected growth rate for the U.S. economy in 2015 due to a downward revision to household spending; however, the projected growth rate for the U.S. economy in 2016 and 2017 remained relatively unchanged. 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 May 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 eight months of fiscal year 2015, the federal budget deficit was $365 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 2Q 2015 Quarterly Review," June 2015, <http://www.renaissancecapital.com/news/us-ipo-market-takes-off-again-in-the-second-quarter:-renaissance-capitals-2q-2015-review-33286.html>.

5. U.S. Department of Treasury, "May 2015 Monthly Treasury Statement of Receipts and Outlays of the United States Government," May 2015. <https://www.fiscal.treasury.gov/fsreports/rpt/mthTreasStmt/mts0515.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.