



## Economic Review - Third 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 September 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 third quarter of 2015. Labor market conditions continued to improve, with total non-farm payroll employment expanding in July and August. Industrial production expanded overall; however, manufacturing production fell in August due to a large drop in automobile output. Business investment increased moderately, with modest gains in orders of non-defense capital goods and a sharp increase in real spending for non-residential structures excluding mining and drilling. Household spending continued to rise at a moderate pace as real disposable income grew and households' net worth remained high. The recovery in the housing sector remained slow; however, starts on new single-family homes rose early in the third quarter and sales of new and existing homes increased.

### 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 3.9 percent in the second quarter of 2015. Quarterly GDP data for the preceding 20 years is shown in the following figure.



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 67 consecutive months from March 2010 to September 2015, 12.7 million non-farm jobs (net) were created.<sup>1</sup> The unemployment rate peaked at 10.0 percent in October 2009 and has abated to 5.1 percent as of September 2015, the lowest unemployment rate since April 2008.<sup>2</sup> 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 10.0 percent as of September 2015.<sup>3</sup> 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.

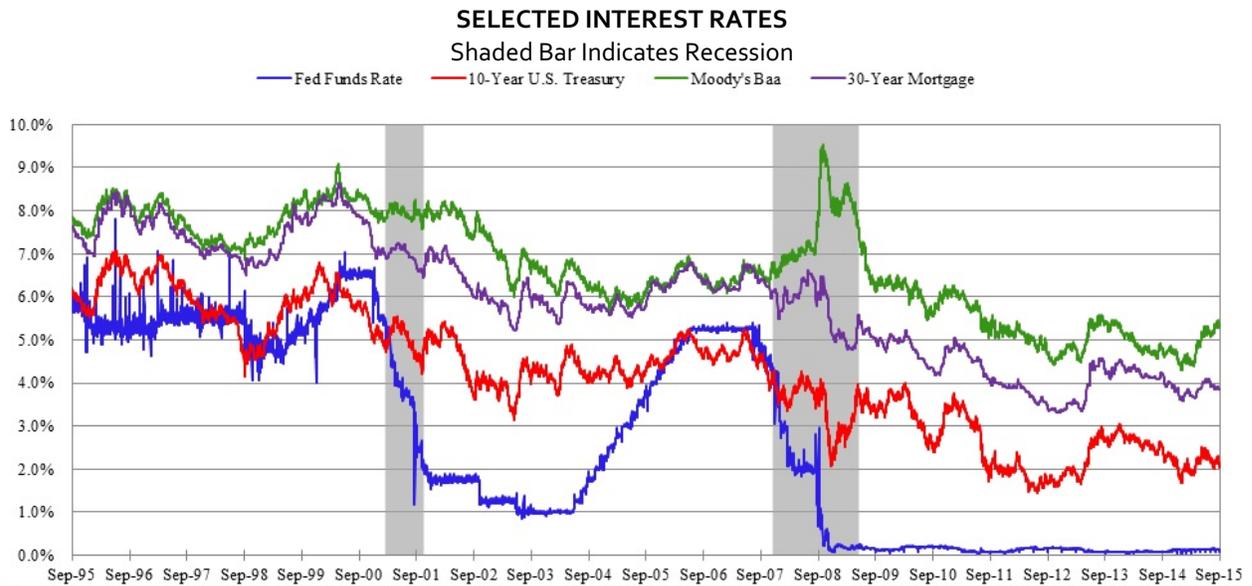


Sources: Department of Labor, Bureau of Labor Statistics, and National Bureau of Economic Research. Data represents non-farm payrolls.

## 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 September 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. The Committee will continue its existing policy of reinvesting proceeds from maturing bonds.

United States financial markets were volatile during the third quarter of 2015, as concerns grew about the prospects for global economic growth, particularly in China. Corporate bond spreads widened slightly although 30-year mortgage rates declined slightly during the third quarter of 2015. Yields on short- and long-term nominal Treasury securities increased. Growth in the issuance of commercial and industrial loans slowed, while commercial real estate loans, automobile loans, and student loans continued to expand robustly in the third quarter of 2015. Market conditions for residential mortgages continued to improve slowly; however, credit availability for borrowers with low credit scores remained tight. The past 20 years of historical interest rate data are shown in the following figure.



Source: Federal Reserve Statistical Release H.15 (519) Selected Interest Rates.

## Current Events

The Standard and Poor's (S&P) 500 stock index had its largest quarterly decline in four years during the third quarter of 2015, down 6.6 percent, as investors were concerned about a Chinese-led global slowdown and continue to speculate over the timing of the first increase in the U.S. federal funds rate since June 2006. When the Federal Reserve begins raising interest rates, other interest rates will also likely increase. Energy and materials stocks, which are tied to Chinese demand for commodities, were the worst performing sector of the S&P 500, and healthcare stocks underperformed due to potential drug price regulations. The other major indices, the Dow Jones Industrial Average (DJIA), the NASDAQ Composite, the S&P Midcap 400, and the Russell 2000 stock indices, fared even worse than the S&P 500, with small-cap stocks declining nearly 12 percent in the third quarter of 2015. Total returns for U.S. stock indices during the third quarter of 2015 and the year-to-date period ended September 30, 2015, are shown in the following figure.

### TOTAL RETURNS OF MAJOR U.S. STOCK INDICES

Index	Third Quarter 2015	Year To Date
S&P 500	(6.44%)	(6.95%)
DJIA	(6.98%)	(5.29%)
NASDAQ Composite	(7.35%)	(2.45%)
S&P MidCap 400	(8.50%)	(4.66%)
Russell 2000	(11.92%)	(7.73%)

The number of initial public offerings (IPOs) and the amount of capital raised slowed in the third quarter of 2015, as a significant number of planned IPOs were withdrawn or delayed due to market conditions. For the first time since 2011, average IPO returns were negative and more IPOs ended the quarter below their offering price than above it. There were 34 IPOs in the third quarter of 2015, a decrease from 60 IPOs in the third quarter of 2014 (a 43 percent year-over-year decline). Healthcare IPOs were the largest category, accounting for 18 IPOs, or 53 percent of all IPOs.<sup>4</sup>



IPO proceeds totaled \$5.1 billion in the third quarter of 2015, an 86 percent decrease from the third quarter of 2014; even without the effect of Alibaba's \$22 billion IPO in 2014, proceeds were down 68 percent year-over-year.

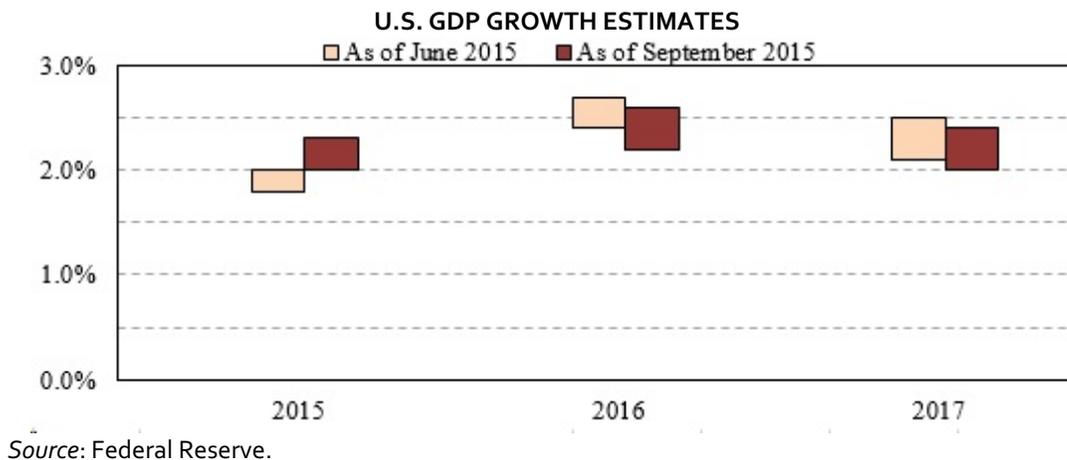
In August 2015, China's central bank, the People's Bank of China (PBOC), allowed its currency, the yuan, to depreciate relative to the U.S. dollar. The PBOC stated that the midpoint for the value of the yuan relative to the U.S. dollar had diverged from market-determined rates and that the PBOC was allowing the market to determine the yuan's value. This shift towards a weaker currency signaled China's potential concern about slowing growth, as China's export sector has weakened – customs data reveals exports declined by 8.3 percent in July 2015, reversing a gain of 2.8 percent in June 2015. Financial markets reacted negatively to this move by the PBOC. As uncertainty surrounds the Chinese economy, central banks around the world have moved to devalue their currencies to help their own exporters and to prevent destabilizing capital flows. Commodities markets are bracing for lower demand in China, the largest consumer of raw materials.

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 were held between Greece and the European Union, the European Central Bank, and the International Monetary Fund from February 2015 to June 26, 2015; however, negotiations broke off and on June 30, 2015, Greece defaulted on a €1.5 billion payment to the International Monetary Fund. As part of the first tranche of loans received by Greece under a third bailout package agreed to in August 2015, Greece must repay about €3.2 billion to the European Central Bank, increase taxes, and cut spending. The package signals Greece's continued membership within the Eurozone.

On August 3, 2015, Puerto Rico defaulted on a \$58 million debt payment, only paying \$628,000. In total, Puerto Rico owes about \$70 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. Governor Alejandro García Padilla has called this default Puerto Rico's economic "death spiral" as the country is in a recession, unemployment is approximately 12 percent – more than double the rate in the United States, and tens of thousands of Puerto Ricans are leaving for the mainland United States in search for jobs. As of the end of the third 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 September, the Federal Reserve increased its projected growth rate for the U.S. economy in 2015 due to higher than expected growth over the first half of 2015; however, the projected growth rate for the U.S. economy was revised downward for 2016 and 2017, reflecting slower projected productivity growth. The estimates for U.S. GDP growth are presented in the following figure.



The U.S. Department of the Treasury's August 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 eleven months of fiscal year 2015, the federal budget deficit was \$530 billion.<sup>5</sup> The CBO's August 2015 report expects that the growth in real GDP from 2015 through 2019 will be driven largely by consumer spending and business and residential investment.<sup>6</sup> Real GDP is projected to grow 2.0 percent in calendar year 2015, 3.1 percent in calendar year 2016, and 2.7 percent in 2017. By the end of 2017, the CBO estimates that the gap between actual GDP and the economy's potential (that is, maximum sustainable) GDP will be eliminated.<sup>7</sup> Real GDP is expected to grow, on average, at an annual rate of 2.2 percent from 2018 through 2019 and 2.1 percent from 2020 through 2025.<sup>8</sup>

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, 2.1 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.<sup>9</sup> Although the global economy continues to recover from the severe recessionary shocks that began in 2007, the process has been slow and uneven.

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. Bureau of Labor Statistics. "Employment, Hours, and Earnings from the Current Employment Statistics survey (National)." <[http://data.bls.gov/timeseries/CES000000001?output\\_view=net\\_1mth](http://data.bls.gov/timeseries/CES000000001?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 3Q 2015 Quarterly Review," September 2015, <<http://www.renaissancecapital.com/news/renaissance-capitals-3q-2015-quarterly-us-ipo-market-review-356>>



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5. U.S. Department of Treasury, "August 2015 Monthly Treasury Statement of Receipts and Outlays of the United States Government," September 2015.  
<<https://www.fiscal.treasury.gov/fsreports/rpt/mthTreasStmt/mtso815.pdf>>.
6. U.S. CBO, "An Update to the Budget and Economic Outlook: 2015–2025," August 2015.  
<<https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/50724-BudEconOutlook-3.pdf>>.
7. Ibid.
8. Ibid.
9. Ibid.