Economic Review - Second Quarter 2017

The state of the general economy can help or hinder a business' prospects by influencing the demand for its goods and services and the availability and price of inputs such as capital and labor. The prevailing economic conditions therefore directly impact the value of a business at a specific point in time. The economic expansion that began in June 2009 is the third longest since the 1850s,[11] but growth has been modest, especially considering the severity of the "Great Recession" of 2007–2009. Recoveries after severe recessions have historically been more robust, as the economy recovers lost ground. The absence of stronger growth is particularly noteworthy given the extraordinarily accommodative monetary policy in recent years.

Summary

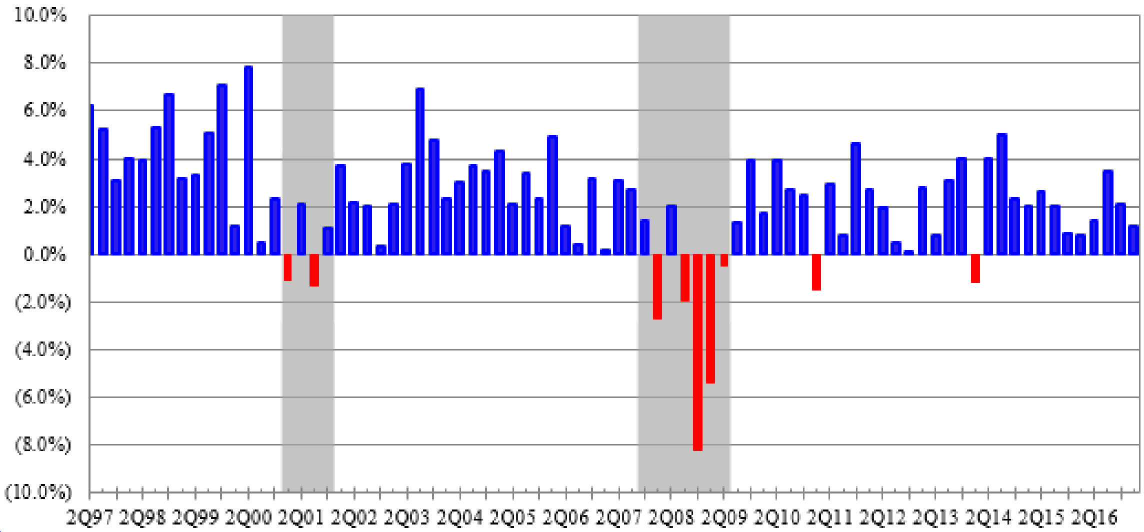
Following the June 13–14, 2017, meeting of the Federal Open Market Committee (the "Committee") of the Federal Reserve, the Committee issued a statement that economic activity was expanding at a faster pace in the second quarter than in the first quarter of 2017. Labor market conditions strengthened as non-farm payroll employment expanded, the unemployment rate decreased to 4.3 percent in May, and the labor force participation rate declined. Industrial production increased considerably, reflecting gains in manufacturing, mining, and utilities output. Household spending improved in the second quarter as there were continued gains in employment, real disposable personal income, and households' net worth. Private expenditures for business equipment and intellectual property increased further in the second quarter, as nominal shipments and new orders of non-defense capital goods excluding aircraft increased. Although spending on commercial structures—excluding those related to mining and drilling—declined in April, the number of crude oil and natural gas rigs in operation continued to rise through early June.

Offsetting these generally positive developments, however, was the slowing of housing activity since the end of the first quarter. Although starts on single-family homes increased in April, building permit issuances for new single-family homes decreased. Additionally, starts on multi-family homes declined and sales on both new and existing homes fell. Consumer price inflation and core inflation, which excludes consumer food and energy prices, continued to run below the Committee's long-run objective of 2 percent.

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 1.2 percent in the first quarter of 2017. 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

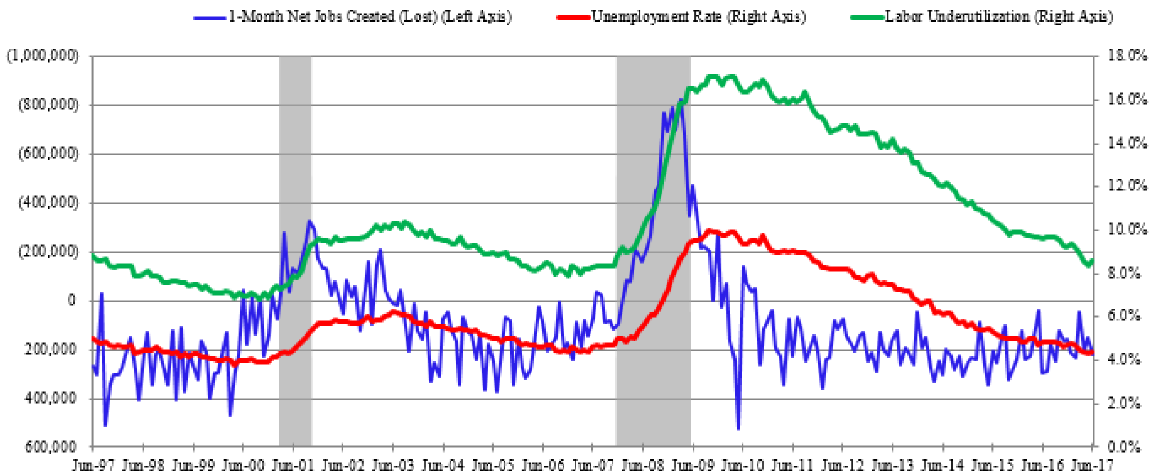


Sources: U.S. Bureau of Economic Analysis and National Bureau of Economic Research.
GDP percent change is based on chained 2009 dollars.

Employment

Employment conditions in the United States have been improving. In the 25 consecutive months from February 2008 to February 2010, 8.7 million non-farm jobs (net) were lost. In the 88 consecutive months from March 2010 to June 2017, 16.7 million non-farm jobs (net) were created.[22] The unemployment rate peaked at 10.0 percent in October 2009 and reached a low of 4.3 percent in May 2017, the lowest unemployment rate since February 2001.[33] 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 8.6 percent as of June 2017.[44] Underemployment restrains 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



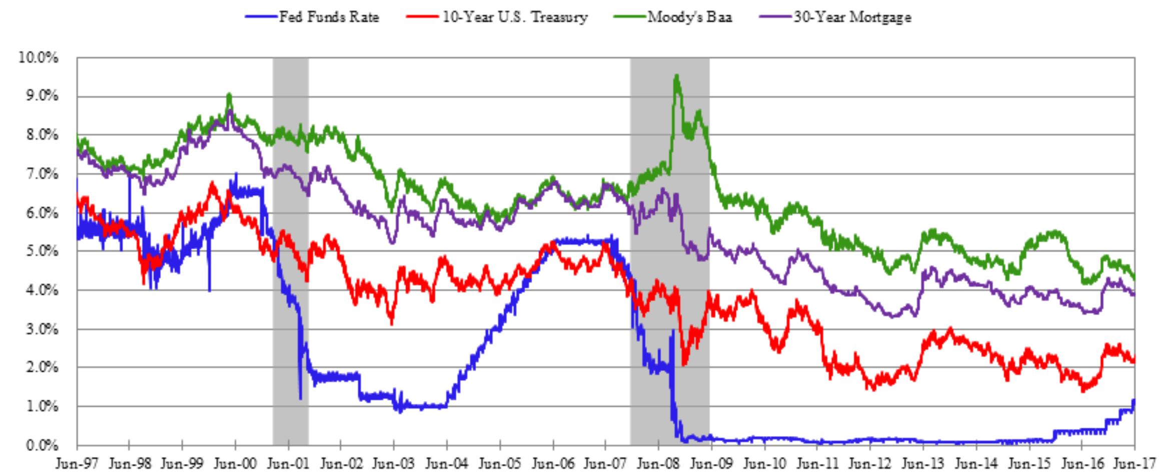
Sources: Department of Labor, Bureau of Labor Statistics, and National Bureau of Economic Research. Data represents non-farm payrolls.

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 13–14, 2017, meeting, the Committee considered the outlook for economic activity, the labor market, and inflation. The Committee weighed the uncertainties associated with the outlook and raised the federal funds rate from a range of 0.75-to-1.00 percent to a range of 1.00-to-1.25 percent, the third increase in three quarters and the fourth increase in a decade. The Committee is continuing its policy of reinvesting proceeds from maturing bonds that it purchased in previous rounds of "quantitative easing."

United States financial markets were supportive of economic growth and employment in the second quarter of 2017. Corporate bond spreads and 30-year mortgage rates declined during the second quarter. Shorter maturity treasury yields increased during the quarter, while longer-term Treasury yields finished the quarter slightly down, on net, from the end of the first quarter of 2017. Treasury-inflation-protected securities declined in the second quarter, in part reflecting below-expectations inflation data. The issuance of commercial and industrial loans increased in the second quarter and corporate bond issuance was strong. Financing for consumers remained accommodative, as consumer loan balances expanded and there was robust growth in the issuance of commercial real estate loans. Mortgage lending for home purchases remained high. 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

Stocks increased in the second quarter, as the second quarter marked an end of the earnings recession of the last two years. Earnings increased for a second straight quarter, rebounding from five quarters of declines. First quarter earnings reports exceeded expectations, as overall earnings from the S&P 500 increased by nearly 14 percent compared with the second quarter of 2016, the biggest gain since 2011. Profitability in the energy, materials, financials, and information technology sectors contributed to these gains. On top of positive earnings data, economic data was strong in the second quarter, with data indicating expansion in manufacturing and services, job growth as the economy moves closer towards full employment, and economic improvement internationally, especially within Europe, providing room for the growth of U.S. exports and earnings for U.S. multinational corporations. Counteracting the gains from positive earnings and economic data in the second quarter, however, was political uncertainty surrounding healthcare reform, tax and budget issues, and growing tensions with Syria and North Korea.

The major stock market benchmarks recorded gains in the second quarter. The technology-focused NASDAQ Composite Index outperformed other major indexes, while the smaller-cap indexes had modest gains. Growth stocks outperformed value stocks across all capitalizations, while sector performance varied within the S&P 500. Healthcare stocks increased by 7 percent while telecommunication services stocks declined by 7 percent. Energy stocks were also weak, as oil prices fell into a bear market. Total returns for U.S. stock indices during the second quarter of 2017 are shown in the following figure.

TOTAL RETURNS OF MAJOR U.S. STOCK INDICES

Index	**Second Quarter 2017**	**Year To Date**
S&P 500	3.95%	9.35%
Dow Jones Industrial Average	3.09%	9.34%
NASDAQ Composite (1)	3.87%	14.07%
S&P MidCap 400	1.97%	5.99%
Russell 2000	2.46%	4.99%

Note:
(1) Return represents principal only.

The number of initial public offerings (IPOs) and the amount of capital raised was exceptional in the second quarter of 2017, with 52 IPOs raising $10.6 billion. The number of offerings and capital raised represented the highest level since the second quarter of 2015, and capital raised was double the amount from the second quarter of 2016. Private equity-backed IPOs increased for a fifth straight quarter, totaling 15 IPOs and raising $5.1 billion, a two-year high for deal count and a three-year high for capital raised. Private equity-backed Altice USA, a cable provider, led the quarter in capital raised with $1.9 billion. Altice USA was the biggest U.S. telecommunications IPO since 2000. Venture capital-backed IPOs saw activity double in the second quarter with 16 IPOs raising $1.8 billion, the highest deal count since the fourth quarter of 2015. Venture capital-backed IPOs were led by technology and biotech companies.

The Trump administration has continued to pursue the "repeal and replace" of the Affordable Care Act with a health care reform bill since early March. House Republicans unveiled the American Health Care Act on March 6, which met criticism from conservative and liberal groups. Revisions were made to the bill, with amendments to Medicaid funding, an optional work requirement for Medicaid, and instructions for a $75 billion fund for additional tax credits to buy insurance. Despite these amendments, the bill was pulled from the House of Representatives on March 24, due to inadequate support among House leadership. However, after much division, the House of Representatives passed the bill on May 4, by a vote of 217-213. Due to a report released by the nonpartisan Congressional Budget Office (CBO) on the House Republican's healthcare plan, the Senate introduced a revision to the bill named the Better Care Reconciliation Act. A vote on the Senate bill has yet to happen as of the end of the second quarter, leaving the status of health care reform uncertain.

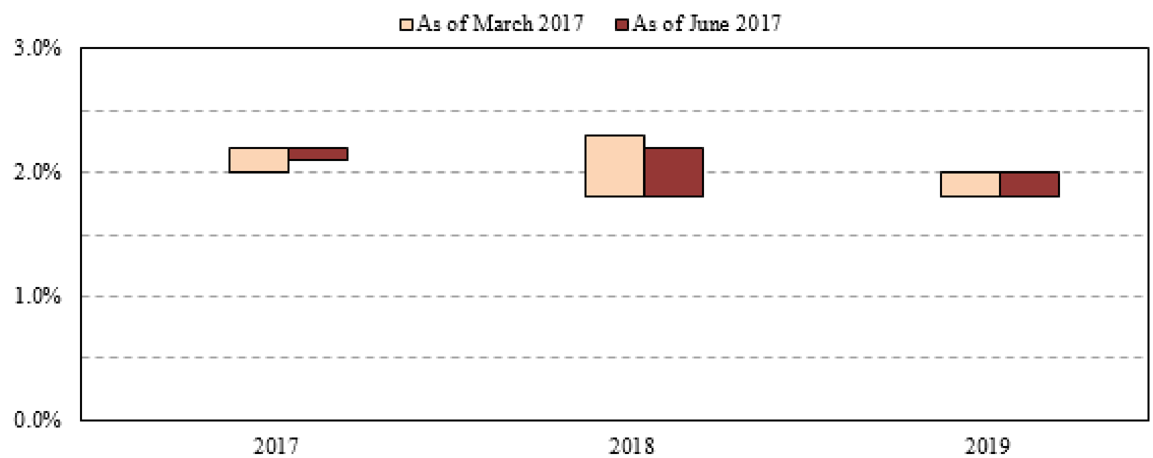
Independent centrist Emmanuel Macron won the French presidential election on May 7 against Front National's right-wing leader Marine Le Pen, signaling a pro-European stance. Also within Europe, the United Kingdom held a general election on June 8, in which each of the U.K.'s 650 constituencies voted for a Member of Parliament to represent them in the House of Commons. The general election came about after a call by U.K. Prime Minister Theresa May in April for the general election, three years before the next one scheduled for May 2020, to strengthen her hand in Brexit negotiations. Her call was successfully backed by a vote of 522 to 13 in the House of Commons. In a shocking result from the general election, May's Conservative Party remained the largest single party in terms of seats (317) and votes (42.3 percent), but were short of a parliamentary majority, resulting in a hung parliament. Despite the loss of seats, May vowed to remain as party leader and prime minister, with the intention of forming a minority government with the support of the Democratic Unionist Party; the government was formed on June 11, and a finalized agreement between the Conservative and Democratic Unionist parties was signed on June 26.

On March 29, Prime Minister Theresa May invoked Article 50 of the European Union's Lisbon Treaty, officially starting the two-year window under which Britain will negotiate its new relationship with the European Union. The European Union (Withdrawal) Bill was introduced to the House of Commons on June 13, which will repeal the European Communities Act 1972. Furthermore, talks began on June 19 between the U.K. and European Union, in which a framework was agreed upon to address key issues.

Outlook

Various statistical reporting agencies provide estimates of the U.S. economy's near-term and longer-term growth rates. The Federal Reserve's projected growth rates for the U.S. economy for 2017–2019 were generally unchanged from March to June. 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 2017 Monthly Treasury Statement of Receipts and Outlays of the United States Government states that the federal budget deficit for fiscal year 2016 was $587 billion, an increase of 33.7 percent from $439 billion in fiscal year 2015. For the first eight months of fiscal year 2017, the federal budget deficit was $433 billion.[55] The CBO's June 2017 report expects that the growth in real GDP from 2017 through 2020 will be driven largely by consumer spending and business and residential investment.[66] Real GDP is projected to grow 2.2 percent in calendar year 2017 and 2.0 percent in calendar year 2018.[77] The CBO estimates that the gap between actual GDP and the economy's potential (that is, maximum sustainable) GDP will be eliminated by the end of 2018.[88] Real GDP is expected to grow, on average, at an annual rate of 1.5 percent from 2019 through 2020 and 1.9 percent from 2021 through 2027.[99]

Inflation, as measured by the Core Consumer Price Index, which excludes the effects of food and energy, is forecast to be 1.6 percent in 2017, 1.9 percent in 2018, and remain at an average of 2.0 percent per year in the 2019–2027 period.[1010]

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. National Bureau of Economic Research. <https://www.nber.org/cycles.html>.

2. 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>.

3. 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>.

4. 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.

5. U.S. Department of Treasury, "May 2017 Monthly Treasury Statement of Receipts and Outlays of the United States Government," June 2017. <https://www.fiscal.treasury.gov/fsreports/rpt/mthTreasStmt/mts0517.pdf>.

6. U.S. CBO, "An Update to the Budget and Economic Outlook: 2017–2027," June 2017. <https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/52801-june2017outlook.pdf>.

7. Ibid.

8. Ibid.

9. Ibid.

10. Ibid.