

Quarterly Economic Review As of June 30, 2019

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 second longest since the 1850s,¹ 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.

Following the June 18-19, 2019, meeting of the Federal Open Market Committee (the "Committee") of the Federal Reserve, the Committee issued a statement that the economy grew at a moderate rate in the second quarter of 2019. Labor market conditions remained strong in the second quarter as non-farm payroll employment expanded, the unemployment rate remained low at 3.7 percent in June, although the labor force participation decreased. Additionally, the rate of private sector job openings remained near the previous quarters' high levels, and average hourly earnings increased 3.1 percent over the 12 months ending in May.² U.S. consumer price inflation and core price inflation, which excludes consumer food and energy prices, remained close to the Committee's long-run objective of 2.0 percent.

Industrial production data was mixed, and manufacturing output decreased in the second quarter of 2019. Household spending increased in the second quarter following a weak start to the year. Housing activity varied in the second quarter, with starts on single-family homes remaining unchanged and starts on multi-family units increasing. Issuance of building permits remained unchanged from the first quarter, and sales of new and existing homes declined in April. Real private expenditures were flat in the second quarter. Nominal shipments and new orders of non-defense capital goods excluding aircraft continued to decline in April. Additionally, real business spending for nonresidential buildings fell in April, and the number of crude oil and natural gas rigs in operation continued to decline throughout the second quarter.

Gross Domestic Product

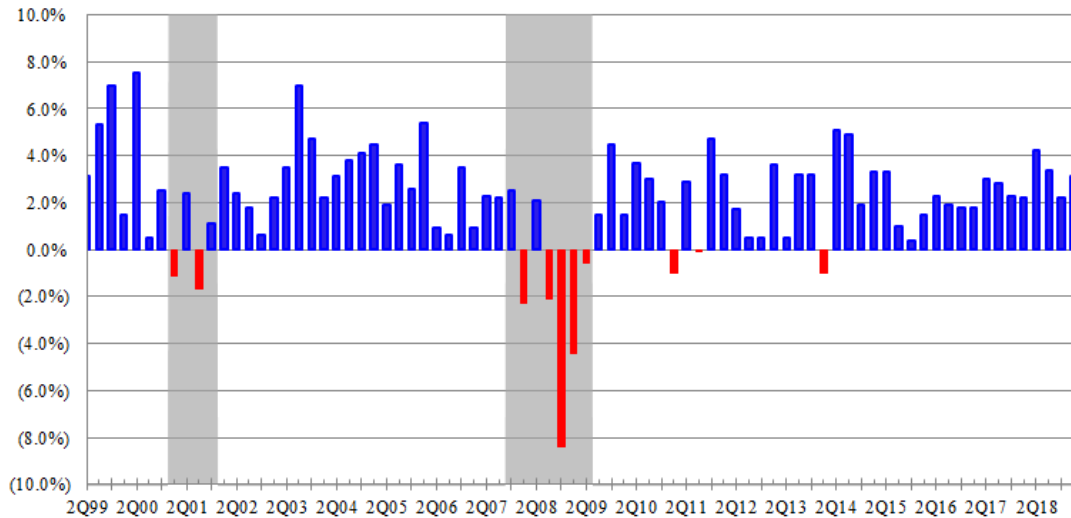
The U.S. Bureau of Economic Analysis estimates that real gross domestic product (GDP) — the output of goods and services produced by labor and property located in the United States — increased at an annual rate of 3.1 percent in the first quarter of 2019. Quarterly GDP data for the preceding 20 years is shown in the following figure.

¹ National Bureau of Economic Research. <<https://www.nber.org/cycles.html>>.

² Federal Reserve Bank of St. Louis. <<https://fred.stlouisfed.org/series/LMJVPRUVUSQ175S>>.

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

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 112 consecutive months from March 2010 to June 2019, 21.6 million non-farm jobs (net) were created.³ The unemployment rate peaked at 10.0 percent in October 2009, fell to a 49-year low of 3.6 percent in April 2019, and was 3.7 percent in June 2019.⁴ 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, reached an 18-year low of 7.1 percent in May 2019 and was 7.2 percent as of June 2019.⁵ Unemployment and underemployment restrain economic growth as consumers are unable or hesitant to spend. The past 20 years of employment data are presented in the following figure.

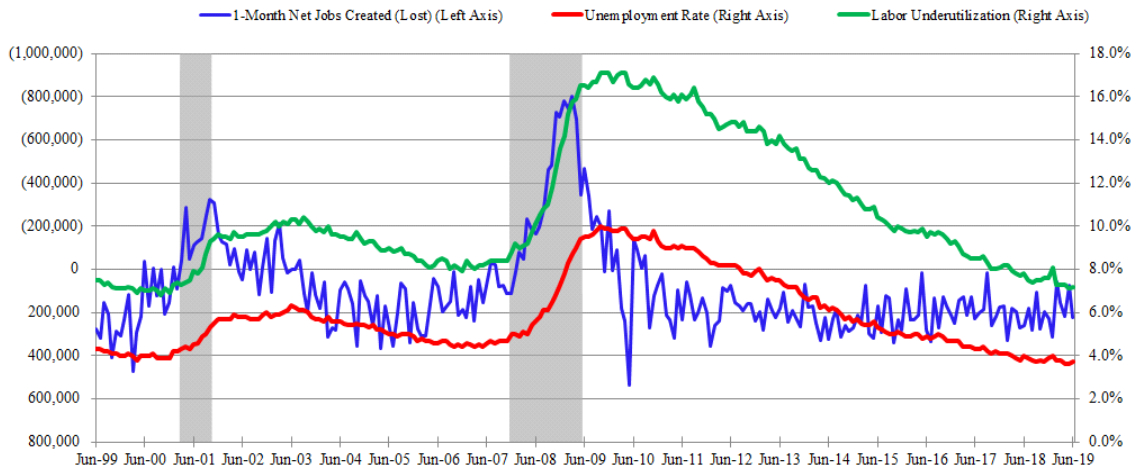
³ Bureau of Labor Statistics. "Employment, Hours, and Earnings from the Current Employment Statistics survey (National)." <http://data.bls.gov/timeseries/CES0000000001?output_view=net_1mth>.

⁴ 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>>.

⁵ "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.

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.

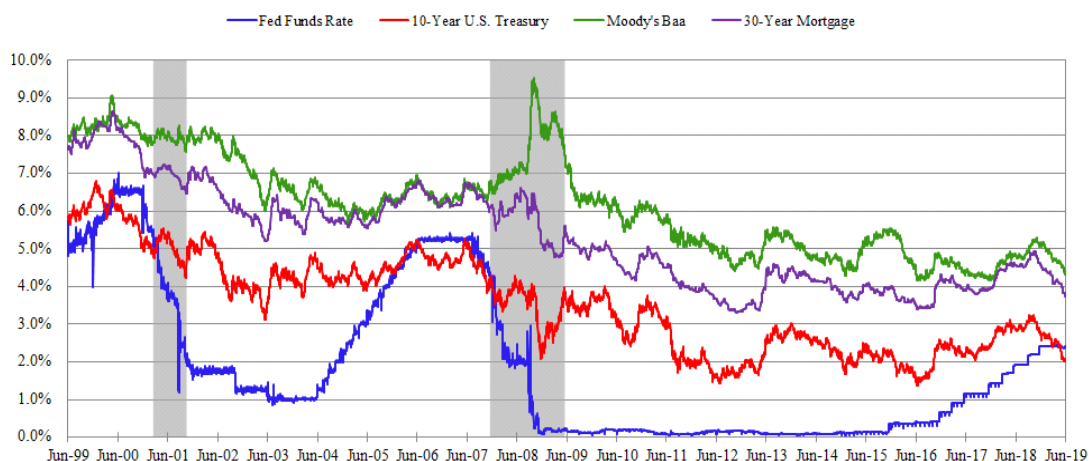
Interest Rates

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 18-19, 2019, meeting, the Committee considered the outlook for economic activity, the labor market, and inflation. The Committee weighed the uncertainties associated with the economic outlook and maintained the federal funds rate at a range of 2.25-to-2.50 percent. The Committee stated it will closely monitor the outlook for economic activity, the labor market, and inflation in its decision for any future rate adjustments.

United States financial markets matched the trend of a slowing economy in the second quarter of 2019. Corporate bond spreads, 30-year mortgage rates, and short-term Treasury yields all declined notably in the second quarter. In addition, long-term Treasury yields decreased considerably, reflecting a further flattening of the yield curve. Measures of inflation based on treasury-inflation-protected securities also fell appreciably, while municipal bond issuance remained accommodative in the second quarter. The issuance of institutional leveraged loans and corporate bonds rebounded late in the second quarter following weak performance in recent months. Financing conditions for consumers remained supportive of growth in household spending. Conditions for commercial real estate loans remained accommodative and consistent with previous quarters. Conditions for residential mortgage financing remained accommodative for most borrowers, and the demand for mortgage credit picked up after sluggish demand in recent quarters, as mortgage rates continue to be relatively low. 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

Following sizable losses in May, U.S. stock markets rebounded to post moderate gains in the second quarter of 2019. The S&P 500 Index reached a record high and ended the second quarter with its best six-month start in over 20 years. The growth in stocks was widespread, with all but one sector (energy) reporting positive returns for the second quarter of 2019.⁶

The stock market reflected numerous developments in trade relationships during the second quarter. The quarter started with optimism surrounding the possibility of a trade deal between the U.S. and China. That optimism receded when the U.S. announced an increase in tariffs from 10 percent to 25 percent on \$200 billion worth of Chinese goods. This drove the S&P 500 Index to its second largest one-day loss of 2019. The stock market continued to decline as China implemented retaliatory tariffs on \$60 billion worth of U.S. goods. Trade sentiment normalized in June, as President Trump's position on placing new tariffs on goods from Mexico over their immigration policies eased, as well as a short-term truce with China that neither side will enact new tariffs for the time being. Federal Reserve Chair Jerome Powell recently signaled that a rate cut may be likely in the near future, which fueled optimism and lifted the stock market for a solid end to the second quarter.

All the major stock market benchmarks recorded modest gains in the second quarter. The Chicago Board Options Exchange Volatility Index (VIX) remained relatively stable in the second quarter, with the exception of several spikes responding to trade news. The financials sector exceeded all other sectors with an

⁶ T. Rowe Price, "Quarterly Market Review," July 17, 2019. <<https://www.troweprice.com/financial-intermediary/us/en/insights/articles/2019/q3/quarterly-market-review.html>>.

eight percent return.⁷ The S&P 500 Index led the three major indices, followed by the NASDAQ Composite Index and the Dow Jones Industrial Average Index. The Russell 2000 Index and S&P MidCap 400 trailed the large-cap indices but have recorded strong returns year-to-date due to a solid first quarter. Total returns for U.S. stock indices during the second quarter of 2019 are shown in the following figure.

TOTAL RETURNS OF MAJOR U.S. STOCK INDICES

Index	Second Quarter 2019	Year to Date
S&P 500	4.3%	18.5%
Dow Jones Industrial Average	3.2%	15.4%
NASDAQ Composite (1)	3.6%	20.7%
S&P MidCap 400	3.0%	18.0%
Russell 2000	2.1%	17.0%

Note:

(1) Return represents principal only.

The second quarter of 2019 followed a weak start to the year with one of the strongest quarters for initial public offerings (IPOs) in years. During the second quarter, 62 IPOs raised \$25.0 billion, which marks the highest deal count in four years and the most capital raised in five years. IPO activity was highlighted by Uber, which raised \$8.1 billion (the entire IPO market in the first quarter of 2019 raised \$4.7 billion). The IPO market outpaced the major indices by recording a 30 percent gain in the second quarter, largely due to the performance of the technology sector. While Uber headlined the technology stocks, other high profile IPOs such as Pinterest, Chewy, and Zoom Video fueled the sector's strong performance. In addition, Beyond Meat helped propel the IPO market as its share price has grown 542 percent since it began trading. Expectations for IPOs in 2019 continue to be strong with a number of large firms set to begin trading in the second half of the year.⁸

Trade

Trade concerns have continued to influence the economy. While the future trade relationship between the U.S. and China remains uncertain, both countries agreed to a tentative trade truce before their meeting at the G20 Summit.⁹ While the length of the truce was not explicitly stated, further trade talks are scheduled in the near future, fueling optimism for a new trade deal. The US-Mexico-Canada Agreement (USMCA) was signed in November 2018, but will not go into effect until it is ratified by the U.S. Congress, which does not appear imminent.

⁷ Ibid.

⁸ Renaissance Capital, "U.S. IPO Market: 2Q 2019 Quarterly Review," June 27, 2019. <<https://www.renaissancecapital.com/Review/2Q19USReviewPublic.pdf>>.

⁹ Reuters, "U.S., China Agree to Tentative Trade Truce Ahead of G20 Summit," June 26, 2019. <<https://www.reuters.com/article/us-usa-trade-china-truce/u-s-china-agree-tentative-trade-truce-ahead-of-g20-summit-scmp-idUSKCN1TS0AZ>>.

Respectively, Mexico, Canada, and China represent the top three trading partners of the United States, making U.S. trade policy among these three countries critical to the health of the American economy.¹⁰

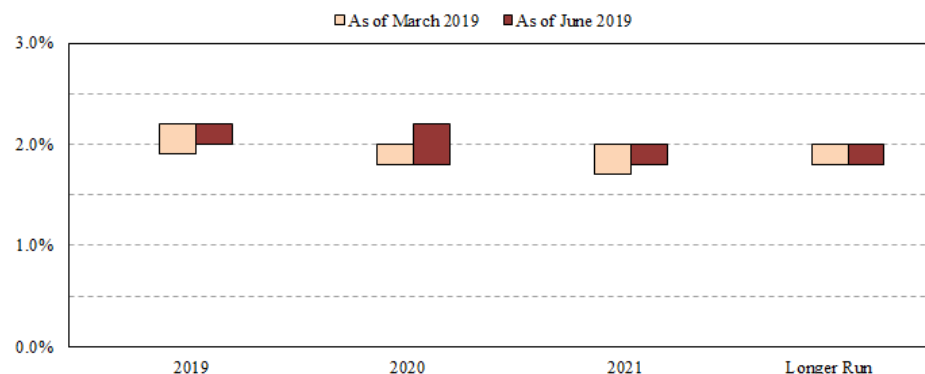
U.S. Federal Government Shutdown

On December 22, 2018, the U.S. Federal Government failed to pass a continuing resolution to fund roughly 25 percent of its operations which led to a 35 day shutdown lasting until January 25, 2019. The closure of nine departments directly impacted an estimated 800,000 federal employees who were either forced to work without pay or were furloughed for the duration of the shutdown, plus federal contractors and others indirectly employed by the U.S. government.¹¹ The U.S. Congressional Budget Office's (CBO) January 2019 report noted that the shutdown negatively affected compensation, federal purchases, and private economic activity. Overall, the CBO estimates that real GDP for the first quarter of 2019 will be reduced by \$8 billion (0.2 percent) as a result of the shutdown. However, the report also states that this loss to GDP is expected to be short-term, and the shutdown will not affect the level of real GDP in the long-run.¹²

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 2019–2021 remained largely consistent from March to June. The projected growth rates for the longer run remain 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.

¹⁰ U.S. Census Bureau, “Top Trading Partners - March 2019,” June 11, 2019. <<https://www.census.gov/foreign-trade/statistics/highlights/top/top1903yr.html>>.

¹¹ Reuters, “Departments Affected by Partial U.S. Government Shutdown,” December 22, 2018. <<https://www.reuters.com/article/us-usa-congress-budget-departments-factb/factbox-departments-affected-by-partial-u-s-government-shutdown-idUSKCN1OL009>>.

¹² U.S. CBO, “The Effects of the Partial Shutdown Ending in January 2019,” January 28, 2019. <<https://www.cbo.gov/system/files/2019-01/54937-PartialShutdownEffects.pdf>>.

The U.S. Department of the Treasury's May 31, 2019, Treasury Statement of Receipts and Outlays of the United States Government states that the federal budget deficit for the first eight months of fiscal year 2019 was \$739 billion, in comparison to \$532 billion for the same period in fiscal year 2018.¹³ The CBO's January 2019 report expects that the growth in real GDP for 2019 will be driven by business investment and government purchases; growth in 2019 will be primarily supported by consumer spending, as well as business and residential investment to a lesser degree.¹⁴ Real GDP is projected to grow 2.3 percent in calendar year 2019, 1.7 percent in calendar year 2020, and 1.6 percent in calendar year 2021.¹⁵ The CBO estimates excess demand to push inflation above the Federal Reserve's 2.0 percent target and drive unemployment lower than the natural rate for 2019 and part of 2020, and then stabilize near their respective long-term rates in the following years. Interest rates are expected to increase as the Federal Reserve has indicated further rate hikes to the Federal Funds Rate in the coming years, which will exert upward pressure on the unemployment rate (which has been below the natural rate since late 2017). Higher interest rates are expected to slow the output growth, and excess demand is expected to begin to diminish after 2019.¹⁶ Real GDP is expected to grow, on average, at an annual rate of 1.7 percent in 2020, 1.6 percent from 2021 through 2022, and 1.8 percent from 2024–2029.¹⁷

Inflation, as measured by the core personal consumption expenditure (PCE), which excludes the effects of food and energy, is forecast to be 1.8 percent in 2019, 1.9 percent in 2020, 2.0 percent in 2021, and average 2.0 percent per year in the longer run.¹⁸ The core PCE inflation rates are presented in the following figure.

¹³ U.S. Department of the Treasury, "Monthly Treasury Statement," May 31, 2019. <<https://fiscal.treasury.gov/files/reports-statements/mts/mts0519.pdf>>.

¹⁴ U.S. CBO, "The Budget and Economic Outlook: 2019 to 2029," January 2019. <<https://www.cbo.gov/system/files/2019-03/54918-Outlook-3.pdf>>.

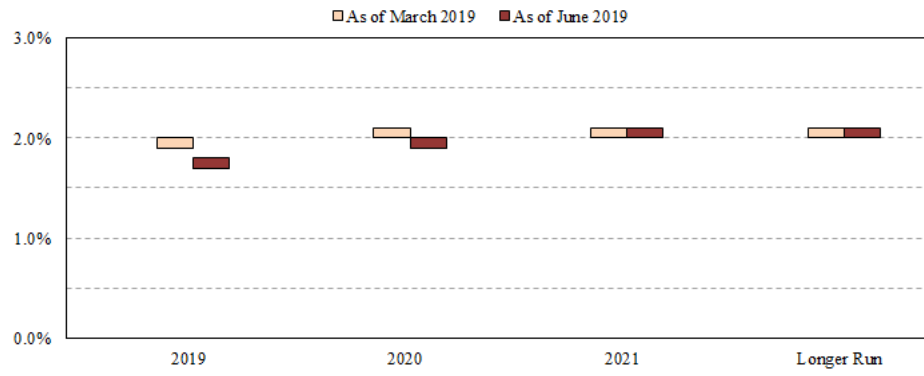
¹⁵ Ibid.

¹⁶ Ibid.

¹⁷ Ibid.

¹⁸ Ibid.

U.S. CORE PCE INFLATION ESTIMATES



Source: Federal Reserve.