

Quarterly Economic Review As of September 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 September 17-18, 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 third quarter of 2019. Labor market conditions remained strong in the third quarter as non-farm payroll employment expanded, the unemployment rate dropped to a 50-year low of 3.5 percent in September, and the labor force participation increased. Additionally, the rate of private sector job openings remained near the previous quarters' high levels, and average hourly earnings increased 3.2 percent over the 12 months ending in August.² U.S. consumer price inflation and core price inflation, which excludes consumer food and energy prices, increased at rates of 1.4 and 1.6 percent, respectively, over the past 12 months ending in July. While the Committee has noted these are below its long-run objective of 2.0 percent, inflation is expected to approach 2.0 percent in the coming years.

Industrial production increased slightly in the third quarter, but remained lower than at the beginning of 2019 and is expected to drag through the end of the year. Household spending increased at a strong pace in the third quarter. Housing activity rebounded from a slow start to the year, with starts on single-family homes and multi-family units increasing in the third quarter. Issuance of building permits rose in the third quarter, and sales of new and existing homes were mixed. Real private expenditures declined in the third quarter. Nominal shipments and new orders of non-defense capital goods excluding aircraft continued to decline in July. Additionally, real business spending for nonresidential buildings decreased, and the number of crude oil and natural gas rigs in operation continued to decline throughout the third quarter.

Gross Domestic Product

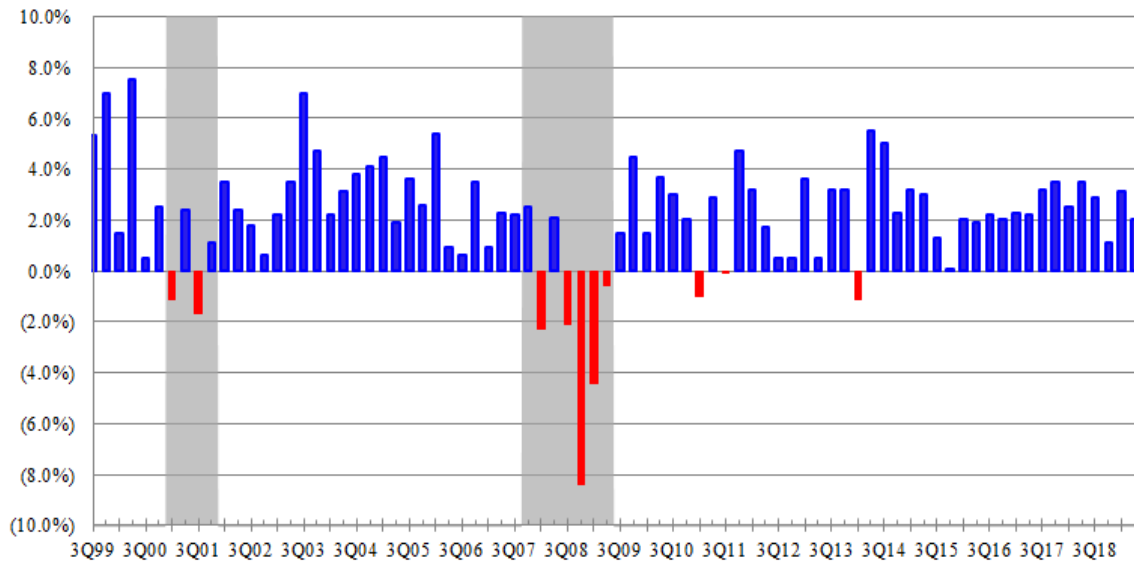
The U.S. Bureau of Economic Analysis estimates that real gross domestic product (GDP) — the output of goods and services produced by labor and property located in the United States — increased at an annual rate of 2.0 percent in the second quarter of 2019. Quarterly GDP data for the preceding 20 years 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 115 consecutive months from March 2010 to September 2019, 22.1 million non-farm jobs (net) were created, making it the second longest economic expansion in the U.S. on record (behind the expansion from 1991 to 2001).³ The unemployment rate peaked at 10.0 percent in October 2009 and fell to a 50-year low of 3.5 percent in September 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 a 19-year low of 6.9 percent in September 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.

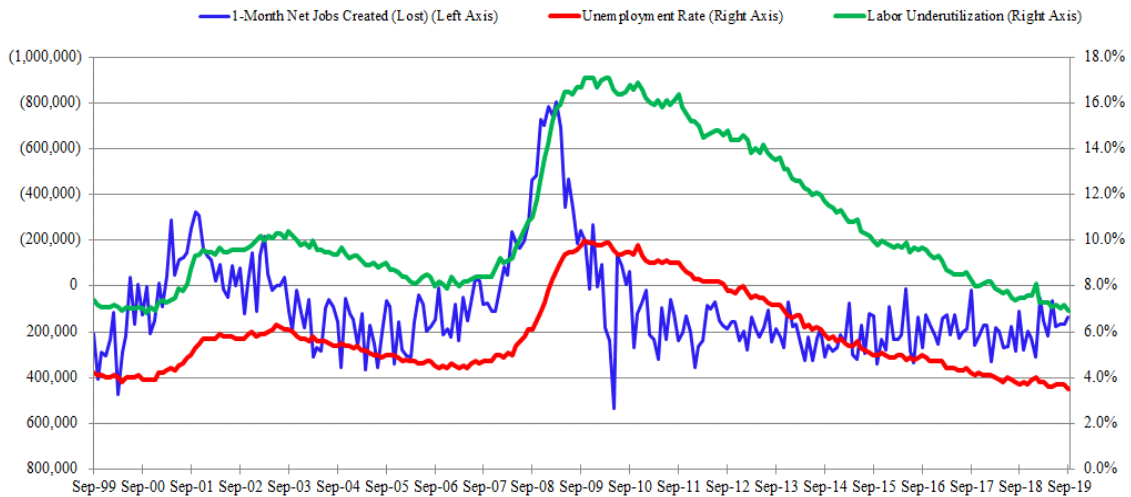
³ Bureau of Labor Statistics. "Employment, Hours, and Earnings from the Current Employment Statistics survey (National)." <http://data.bls.gov/timeseries/CES0000000001?output_view=net_1mth>.

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.

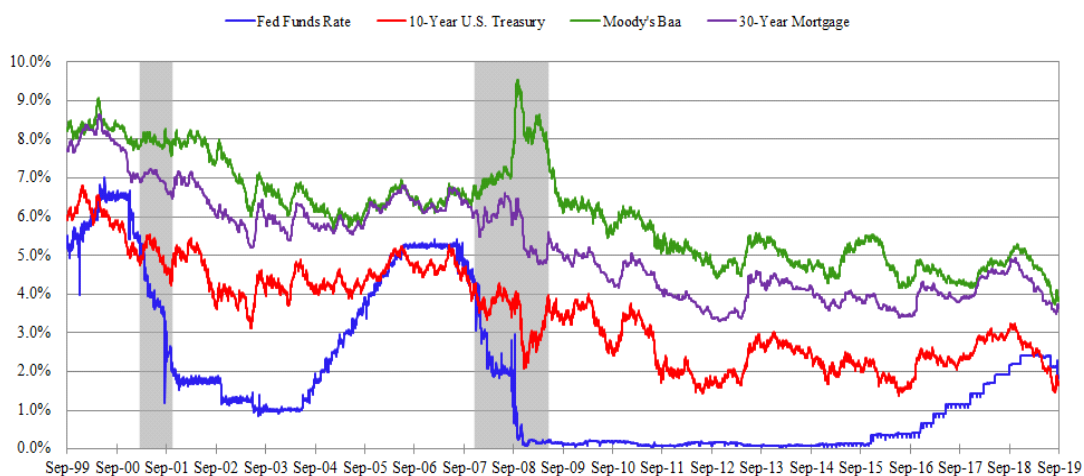
Interest Rates

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 September 17-18, 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 lowered the federal funds rate to a range of 1.75-to-2.00 percent. The Committee stated it will closely monitor the impact of incoming information and will act appropriately to sustain the current expansion.

United States financial markets, fueled by growth and trade concerns, fluctuated but remained generally accommodative of spending and economic activity in the third quarter of 2019. Corporate bond spreads, 30-year mortgage rates, and short-term Treasury yields all declined notably in the third quarter. In addition, long-term Treasury yields decreased considerably, reflecting a further flattening of the yield curve and concerns of a possible inversion. Measures of inflation based on treasury-inflation-protected securities also fell appreciably. The issuance of corporate bonds remained solid in the third quarter, driven by strong investment-grade bond issuance. Financing conditions for consumers remained supportive of growth in household spending despite the instability in the financial markets. Conditions for commercial real estate loans remained accommodative and consistent with previous quarters. Conditions for residential mortgage financing remained accommodative for most borrowers, 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

The major indexes' returns were mixed in the third quarter of 2019. The S&P 500 Index moved slightly higher to help build upon its record start to the year. The Dow Jones Industrial Average Index moved higher as well, while the poor performance from the technology sector kept the NASDAQ Composite Index flat. Performance varied between sectors in the third quarter of 2019. Utilities led the way by gaining nine percent, while energy stocks dropped over six percent. Although it had a marginal third quarter, technology shares have still been the strongest sector year-to-date with an over 30 percent return.⁶

The third quarter started on a positive note with fresh news of the announced trade truce between the U.S. and China. In addition, comments from Fed Chair Jerome Powell signaling flexibility to lower rates were well received by the stock market. This drove the S&P 500 Index to its all-time high and peak for the third quarter on July 25. The stock market quickly changed course, however, as President Trump announced new tariffs of 10 percent on \$300 billion worth of goods and the Chinese government allowed their currency (the yuan) to fall below the established threshold of 7.0 yuan per U.S. dollar. The U.S. then declared China a "currency manipulator" which led the Chinese to impose new tariffs on \$75 billion worth of U.S. goods and ordered a freeze on purchasing U.S. agricultural products. After a 0.25 percent rate cut in July fell below the markets' expectations, an additional 0.25 percent rate cut occurred in September. Markets still fell following the cut due to Jerome Powell indicating the Fed may be taking more of a "wait and see" approach rather than aggressively looking to change rates at this point in time. The third quarter ended on a positive note, however, with the U.S. and China both easing on some of their previous trade threats.

⁶ T. Rowe Price, "Quarterly Market Review," October 21, 2019. <<https://www.troweprice.com/personal-investing/planning-and-research/t-rowe-price-insights/markets/quarterly-market-review.html>>.

The Dow Jones Industrial Average Index and the S&P 500 were the only major stock market benchmarks to post a positive return in the third quarter. The Chicago Board Options Exchange Volatility Index (VIX) reflected the instability experienced in the third quarter by reaching its highest point of 2019, largely due to spikes responding to trade news. The financials sector exceeded all other sectors with an eight percent return.⁷ The Dow Jones Industrial Average Index led the three major indices, followed by the S&P 500 Index and the NASDAQ Composite 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 strong first six months of the year. Total returns for U.S. stock indices during the third quarter of 2019 are shown in the following figure.

TOTAL RETURNS OF MAJOR U.S. STOCK INDICES

Index	Third Quarter 2019	Year to Date
S&P 500	1.7%	20.6%
Dow Jones Industrial Average	1.8%	17.5%
NASDAQ Composite (1)	(0.1%)	20.6%
S&P MidCap 400	(0.1%)	17.9%
Russell 2000	(2.4%)	14.2%

Note:

(1) Return represents principal only.

Following a robust second quarter, the third quarter of 2019 resulted in a moderate quarter for initial public offerings (IPOs). During the third quarter, 39 IPOs raised \$10.8 billion, both of which are near the historical average. Healthcare and technology companies provided 62 percent of all IPOs in the third quarter. The IPO Index dropped 11 percent during the quarter, in part due to the highly funded IPOs of SmileDirectClub and Peloton falling well below their IPO price. The expectation for IPOs for the remainder of 2019 have been tampered down quite a bit following an average third quarter, and reported struggles with the potential IPO of WeWork.⁸

Trade

Trade concerns have continued to influence the economy. While the long-term trade relationship between the U.S. and China remains uncertain, both countries have escalated the conflict further by enacting a new round of tariffs. The United States introduced retaliatory tariffs of 15 percent on footwear, smart watches, and select televisions in response to China's 5 percent tariff on U.S. crude oil.⁹ While

⁷ Ibid.

⁸ Renaissance Capital, "US IPO Market: 3Q 2019 Quarterly Review," September 30, 2019. <https://www.renaissancecapital.com/review/3Q19USReviewPublic.pdf?inf_contact_key=de5b4ef192cae243c33f1a9c956ee31d18a532c4142cb79caf2b269de1401fa>.

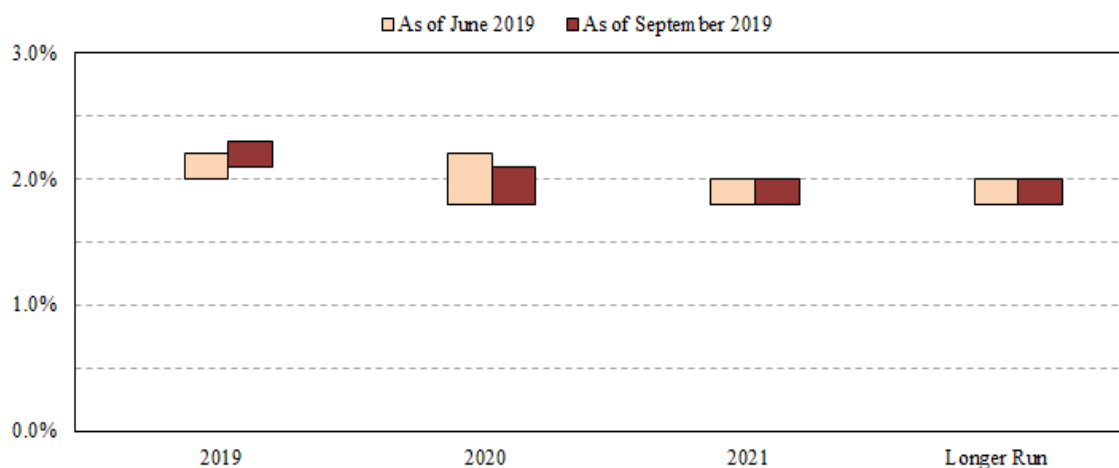
⁹ Reuters, "China, U.S. Kick Off New Round of Tariffs in Trade War," August 31, 2019. <<https://www.reuters.com/article/us-usa-trade-china/china-us-kick-off-new-round-of-tariffs-in-trade-war-idUSKCN1VM0V9>>.

both sides have met for negotiations in September and are scheduled for further talks in October, the Federal Reserve has noted that uncertainty surrounding the trade conflict still remains a drag on the global and domestic economic outlook. 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. 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

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 June to September. The projected growth rates for the longer run remain unchanged from June to September. 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 August 31, 2019, Treasury Statement of Receipts and Outlays of the United States Government states that the federal budget deficit for the first 11 months of fiscal year 2019 was \$1.1 trillion, in comparison to \$898 billion for the same period in fiscal year 2018.¹¹ The CBO’s August 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

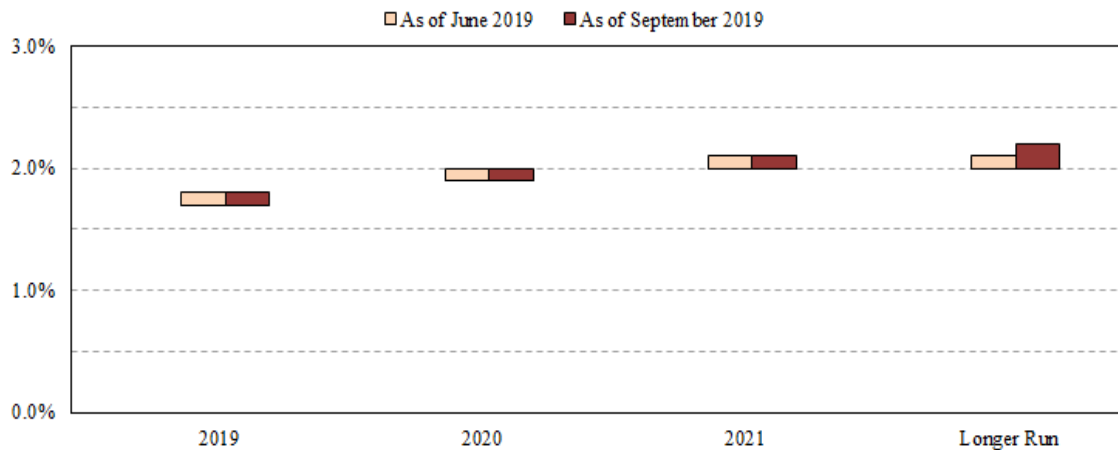
¹⁰ U.S. Census Bureau, “Top Trading Partners - March 2019,” June 11, 2019. <https://www.census.gov/foreign-trade/statistics/highlights/top/top1903yr.html>.

¹¹ U.S. Department of the Treasury, “Monthly Treasury Statement,” August 31, 2019. <https://fiscal.treasury.gov/files/reports-statements/mts/mts0819.pdf>.

investment to a lesser degree.¹² The CBO projects that decreases in these areas will result in slower growth for the next few years. Real GDP is projected to grow 2.3 percent in calendar year 2019, 2.1 percent in calendar year 2020, and 1.8 percent in calendar year 2021.¹³ The CBO estimates excess demand to push inflation slightly above the Federal Reserve’s 2.0 percent target and drive unemployment lower than the natural rate briefly, and then stabilize near their respective long-term rates in the following years. Interest rates are expected to gradually increase as the Federal Reserve has indicated rate hikes to the Federal Funds Rate are likely 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 2019.¹⁴ Real GDP is expected to grow, on average, at an annual rate of 1.8 percent in 2021, 1.7 percent from 2022 through 2023, and 1.8 percent from 2024–2029.¹⁵

Inflation, as measured by the core personal consumption expenditure (PCE), which excludes the effects of food and energy, is forecasted to be 1.9 percent in 2019, 2.2 percent in 2020, 2.1 percent in 2021, and average 2.0 percent per year in the longer run.¹⁶ The core PCE inflation rates are presented in the following figure.

U.S. CORE PCE INFLATION ESTIMATES



Source: Federal Reserve

¹² U.S. CBO, “An Update to the Budget and Economic Outlook: 2019 to 2029,” August 2019. <https://www.cbo.gov/system/files/2019-08/55551-CBO-outlook-update_0.pdf>.

¹³ Ibid.

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ Ibid.