Economic Review - First Quarter 2022

The state of the general economy can help or hinder a business' prospects by influencing the demand for its goods and services. The economy also affects the availability and price of inputs such as capital and labor. The prevailing economic conditions therefore directly affect the value of a business at a specific point in time. The 128-month economic expansion from June 2009 to February 2020 was the longest since the 1850s. The COVID-19 global pandemic suddenly and severely affected economies and markets around the world, causing the U.S. economy to lose nearly 22 million jobs and go into a recession from February 2020 to April 2020, which was the shortest recession in U.S. history. Since returning to growth in April 2020, the U.S. economy has rapidly recovered, adding back over 20 million jobs in the last 23 months.

Summary

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The Federal Open Market Committee (the "Committee") of the Federal Reserve held two meetings during the first quarter of 2022; one in January and one in March to discuss the additional measures being taken to support the economy, which include:

- Increasing the target range for the federal funds rate from zero-to-0.25 percent to 0.25 percent-to-0.50 percent.

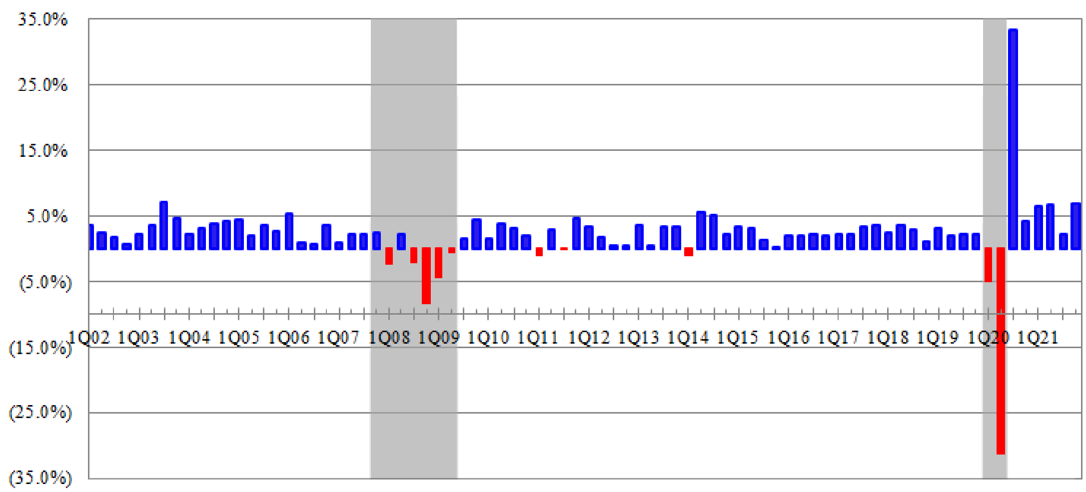
- Signaling that additional rate increases are coming throughout the year and may come in increments of 50 basis points if deemed necessary to reduce inflation toward its 2.0 percent target.

- Concluding its asset purchase program as of its March meeting. The Committee has also indicated that it will begin to reduce its holdings of assets from its nearly $9 trillion balance sheet.

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 capital located in the United States — increased at an annual rate of 6.9 percent in the fourth quarter of 2021. In 2021, GDP increased by 5.7 percent for the year, compared to a 3.5 percent decline in 2020. Quarterly GDP data for the preceding 20 years is shown in the following figure.

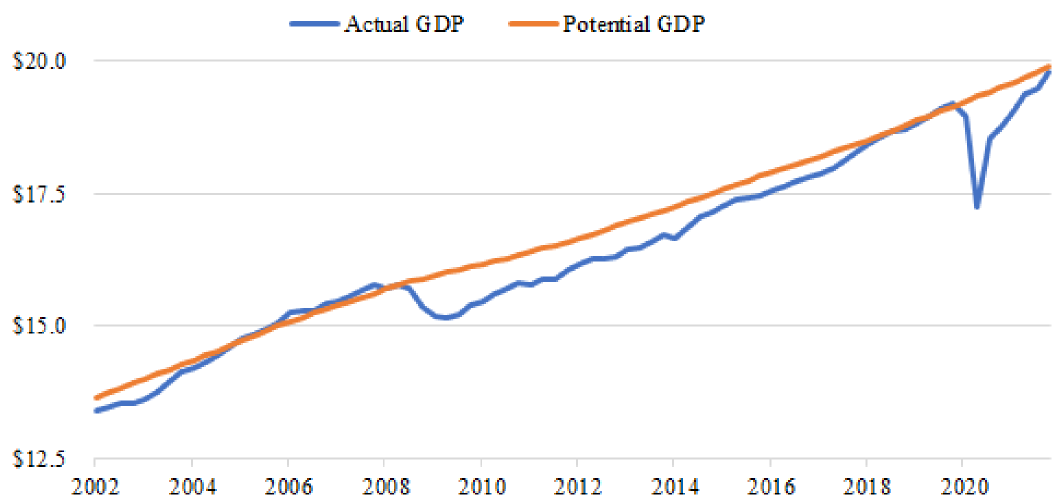
QUARTERLY U.S. GDP GROWTH
Seasonally Adjusted Annualized Rates; Shaded Bar Indicates Recession



Sources: U.S. Bureau of Economic Analysis and National Bureau of Economic Research. GDP percent change is based on chained 2012 dollars.

The brief 2020 recession caused by the COVID-19 pandemic caused real GDP in the U.S. to fall to $17.3 trillion in the first quarter of 2020, which was $2.0 trillion below the $19.3 trillion potential GDP estimated by the Congressional Budget Office. By the fourth quarter of 2021, the economy had reduced this $2.0 trillion shortfall by approximately 85 percent, to $0.3 trillion. Real GDP and potential real GDP for the past 20 years are shown in the following figure.

ACTUAL GDP COMPARED TO POTENTIAL GDP
Amounts in Trillions of U.S. Dollars



Sources: U.S. Bureau of Economic Analysis and Congressional Budget Office. GDP is based on chained 2012 dollars.

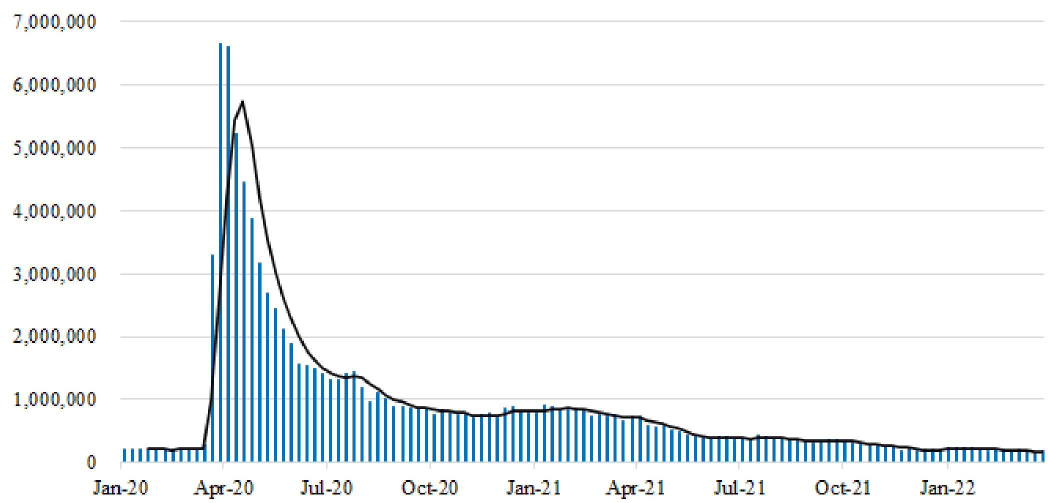
The Federal Reserve publishes estimates of GDP growth. It projects growth to somewhat stabilize to normalized levels in 2022, with GDP growth of 2.8 percent. Thereafter, it projects GDP growth rates of 2.2 percent and 2.0 percent in 2023 and 2024, respectively, before settling at 1.8 percent annual growth for the long-run.

Employment

From March 2010 (the end of the 2008–2009 recession) to February 2020, 23.2 million net non-farm jobs were created.[3] At the end of the first quarter of 2022, the unemployment rate was 3.6 percent. This is only slightly above both the recent multi-decade low of 3.5 percent in February 2020 and the 53-year low of 3.4 percent in 1969. 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, was also near a historical low of 6.9 percent in March 2022.[4]

Beginning in March 2020, national, state, and local governments began instituting lockdowns that forced the closures of many businesses and restricted the free movement of citizens, and a wave of layoffs and furloughs began. Initial unemployment claims, which had averaged 218,000 per week in 2020 prior to the COVID-19 pandemic, spiked to a high of 6,648,000 for the week ending March 28, 2020. However, initial unemployment claims have continued to trend lower to historic lows in recent months, averaging 202,000 throughout the first quarter of 2022 compared to an average of 248,000 in the fourth quarter of 2021. In addition, initial claims for the week ending March 19, 2022, were 166,000, its lowest point since November 1968. Initial claims have subsided from the extreme levels in the first half of 2020 and are now starting to fall below their pre-pandemic levels. Weekly initial unemployment claims and the four-week moving average since the beginning of 2020 are shown in the following figure.

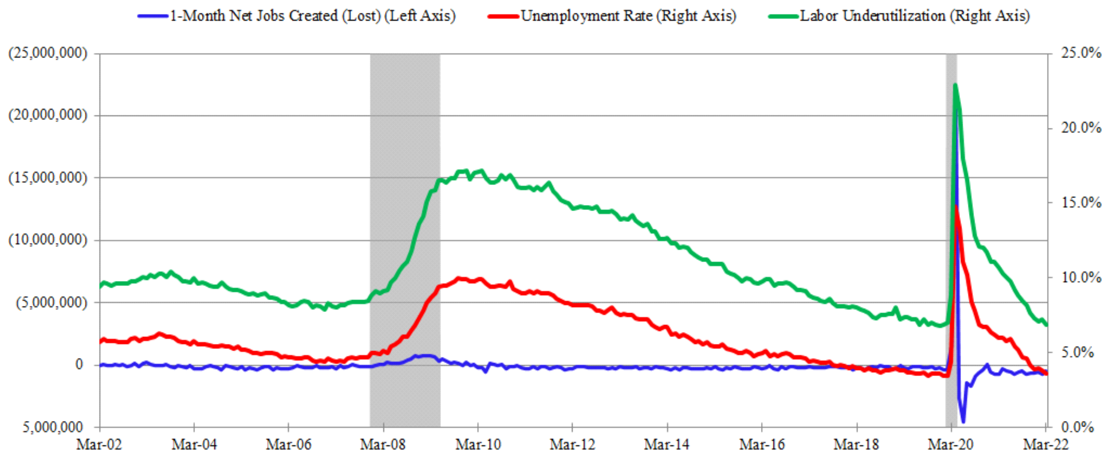
WEEKLY INITIAL UNEMPLOYMENT CLAIMS



Source: Federal Reserve Bank of St. Louis.

Unemployment and underemployment restrain economic growth as consumers are unable or hesitant to spend. The past 20 years of job creation, employment, and underemployment data are presented in the following figure.

MEASURES OF STRESS IN THE LABOR MARKET
Shaded Bar Indicates Recession



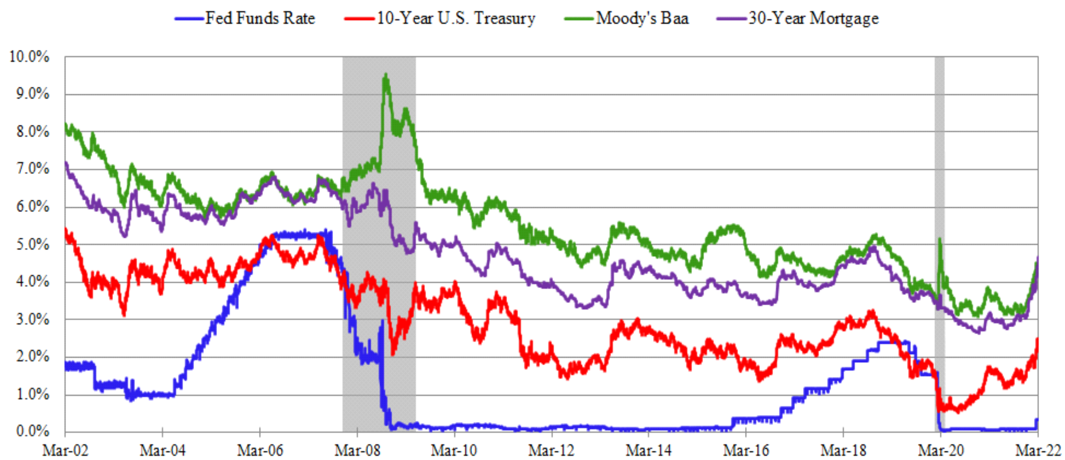
Sources: Department of Labor, Bureau of Labor Statistics, and National Bureau of Economic Research. Data represents non-farm payrolls.

While the labor market has continued to improve in recent quarters and is recovering well from the pandemic, there is still a large number of unfilled job openings. As of February 2022, businesses reported that there were still over 11 million job openings available.[5] In addition, over 4 million workers reportedly quit their jobs in the month of February, a level which has remained near all-time highs in previous months.[6] The higher the rate at which workers quit is generally viewed as a positive sign for the labor market, as workers will usually only quit their job if they believe they can find or have found a better job. The Committee believes that the large number of job openings and workers' willingness to quit their current jobs indicate that labor conditions are generally continuing to improve.

Interest Rates

Interest rates increased during the first quarter of 2022 from their historic lows reached in recent quarters. The yield on the 10-year U.S. Treasury rose 80 basis points by the end of the first quarter, following the Committee's announcement of an increase to the target range for the federal funds rate at its March meeting. At the end of the first quarter of 2022, the yield on the 10-year Treasury reached its highest point since May 2019. The Moody's Baa rate increased by 84 basis points throughout the first quarter as well. The 30-year fixed home mortgage rate reached its highest point since December 2018 to reflect the broad increase in interest rates throughout the first quarter of 2022. Mortgage rates are likely to continue to increase as the Committee executes further interest rate hikes throughout the year and likely into 2023. 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

All the major indices posted negative returns in the first quarter of 2022, following positive returns during the fourth quarter of 2021. Volatility increased throughout the stock market due to concerns over persistently high inflation, Russia's invasion of Ukraine, and the ensuing economic and political effects. Not only is it unclear how much further the conflict will escalate, but investors worldwide are uncertain just how severe the economic sanctions levied on Russia will impact the global energy market, particularly in Europe, which is heavily reliant on Russian oil and gas exports.

The Dow Jones Industrial Average posted the smallest loss of all the major indices throughout the first quarter of 2022. Following robust returns in the fourth quarter of 2021 and for the year as a whole, all major indices began 2022 with moderate negative returns fueled by inflation and the ongoing conflict in Ukraine. Total returns for U.S. stock indices are shown in the following figure.

TOTAL RETURNS OF MAJOR U.S. STOCK INDICES

Index	**First Quarter 2022**
S&P 500	(4.6%)
Dow Jones Industrial Average	(4.1%)
NASDAQ Composite (1)	(9.1%)
S&P MidCap 400	(4.9%)
Russell 2000	(7.5%)

Note:
(1) Return represents principal only.

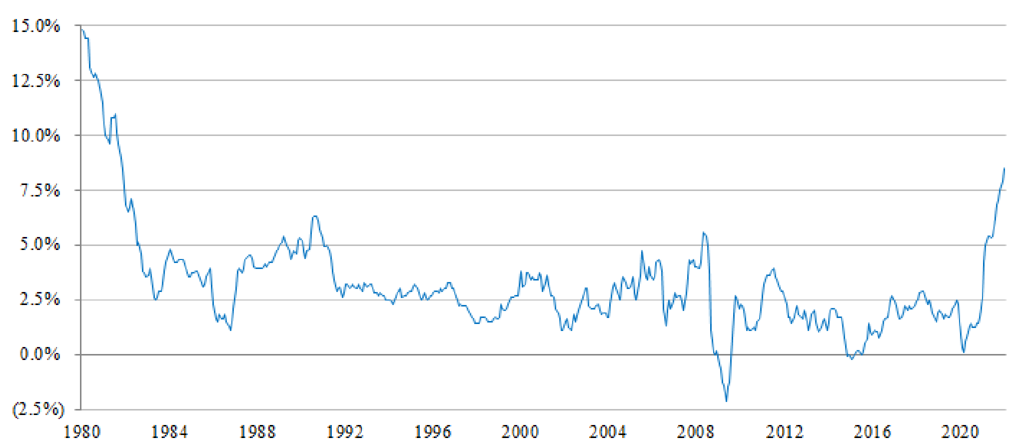
Inflation[7]

Inflation continued to be one of the most prevalent topics surrounding the U.S. economy throughout the first quarter of 2022. The coronavirus pandemic continues to disrupt global supply chains and the Russian invasion of Ukraine has the potential to destabilize the supply of gas and oil worldwide as Europe and the United States have implemented economic sanctions to limit the export of energy from Russia. Chairman Powell has reiterated that the Committee will utilize the appropriate tools to fulfill its dual mandate as directed by Congress, which includes stable prices (defined as 2.0 percent annual inflation). The consumer price index ("CPI") rose by 1.2 percent in the month of March alone, as well as 8.5 percent for the 12 months ending March 2022, which is the highest 12-month increase since December 1981. The price of oil increased by over 22 percent in March alone and was 70 percent higher in March 2022 than one year earlier.

Core CPI, which excludes oil and food due to their volatility, increased by 6.5 percent over the same 12-month period, which is the largest increase since August 1982. Core CPI also rose by 0.3 percent in the month of March, which represents its smallest increase since the second quarter of 2021. Although rising oil and gas prices are still applying upward pressure on overall inflation, this may be a sign that inflation for other goods and services are peaking and perhaps will subside throughout the year. Other than oil, the items that experienced notable price increases during the month of March include food (1.0 percent), transportation services (2.0 percent), and apparel (0.6 percent).

As mentioned, inflation is currently at its highest levels since 1981, which is the last time inflation was comparable to our current environment. As such, the annual change in the CPI since 1980 is shown in the following figure.

ANNUAL CHANGE IN THE CPI



Source: Bureau of Labor Statistics.

As a result of the elevated levels of inflation that began in the second quarter of 2021 and have continued to rise throughout the first quarter of 2022, inflation expectations are beginning to rise as well. The Federal Reserve monitors inflation expectations because if consumers and businesses anticipate an increase in wages and prices, they can adjust their behavior accordingly, making the expected inflation a reality. Every month, the Federal Reserve Bank of New York publishes expectations of inflation over the forward year. Prior to 2020, one-year forward-looking inflation expectations generally remained between 2.5 percent and 3.0 percent since 2014. In 2022, inflation expectations have increased from 6.0 percent in February to 6.6 percent in March.[8]

The Committee has continued to adjust its stance as the outlook of inflation becomes more severe than the Committee initially believed. However, the Committee has recently confirmed its intent to adjust its policies accordingly for the purpose of achieving stable prices. At its March meeting, the members of the Committee provided their outlook of the target range for the federal funds rate in the coming years. All but one member expects the target range to be at least 1.50 percent-to-1.75 percent by the end of 2022. In 2023 and 2024, there is a consensus that the target range should be no less than 2.0 percent as a result of subsequent rate increases to address inflation.[9] In the longer run, the majority of the Committee members indicate a target range between 2.25 percent-to-2.50 percent is likely.

The Federal Reserve publishes estimates of personal consumption expenditures ("PCE") inflation and Core PCE inflation. It projects inflation to begin to subside in 2022, with PCE inflation of 4.3 percent and Core PCE inflation of 4.1 percent. In the years to follow, the Federal Reserve expects inflation to retreat to more moderate levels. It projects PCE inflation of 2.7 percent and 2.3 percent in 2023 and 2024, respectively, supporting its belief that the Committee's policies will not allow the inflationary environment to exist long-term.

Endnotes:

1. National Bureau of Economic Research. <https://www.nber.org/research/data/us-business-cycle-expansions-and-contractions>.

2. Ibid.

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. "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. Bureau of Labor Statistics, "Job Openings and Labor Turnover - February 2022," March 29, 2022, <https://www.bls.gov/jlt/>.

6. Ibid.

7. Bureau of Labor Statistics, "Consumer Price Index - March 2022," April 12, 2022, <https://www.bls.gov/cpi/>.

8. Federal Reserve Bank of New York, "Survey of Consumer Expectations," <https://www.newyorkfed.org/microeconomics/sce#/>.

9. Board of Governors of the Federal Reserve System, "Summary of Economic Projections," March 16, 2022, <https://www.federalreserve.gov/monetarypolicy/fomcprojtable20220316.htm>.