



## Economic Review - Second 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 21 million jobs in the last 26 months.

### Summary

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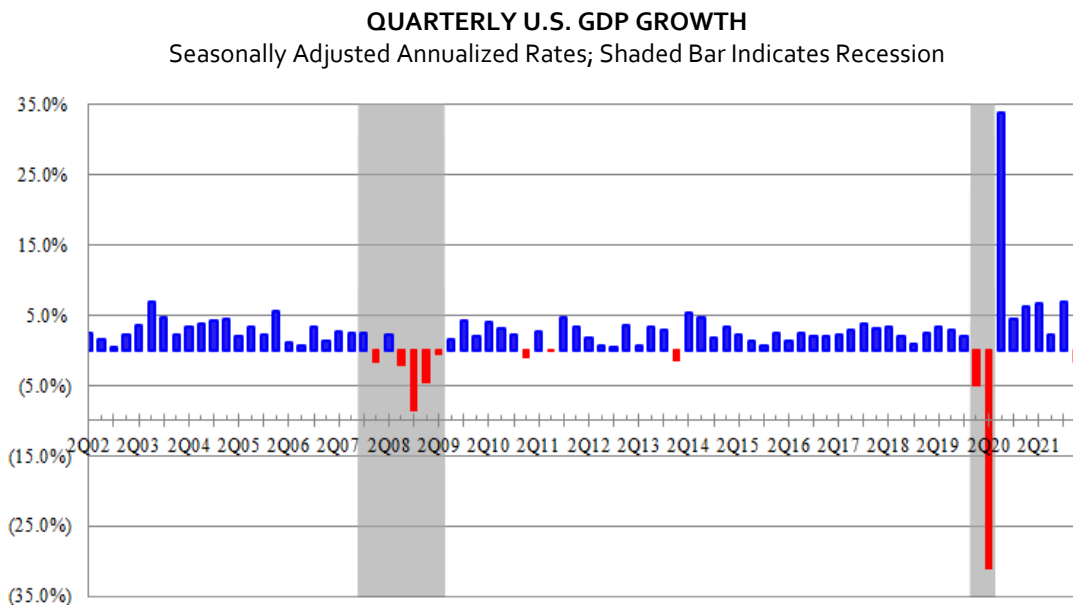
The Federal Open Market Committee (the "Committee") of the Federal Reserve held two meetings during the second quarter of 2022; one in May and one in June to discuss the additional measures being taken to support the economy, which include:

- Increasing the target range for the federal funds rate by 50 basis points in May and 75 basis points in June; representing a total change in the target range from 0.25 percent-to-0.50 percent to 1.50 percent-to-1.75 percent.
- Signaling that additional rate increases are likely to continue throughout the year and may come in varying increments as deemed necessary to reduce inflation toward its 2.0 percent target.
- Beginning its reduction of the assets held on the Federal Reserve's balance sheet by \$47.5 billion per month from May through July; after which the monthly reduction will increase to \$95 billion.<sup>3</sup>



## 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—decreased at an annual rate of 1.6 percent in the first quarter of 2022; representing the first quarterly decline in output since the recovery from the coronavirus pandemic began in the third quarter of 2020. 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.

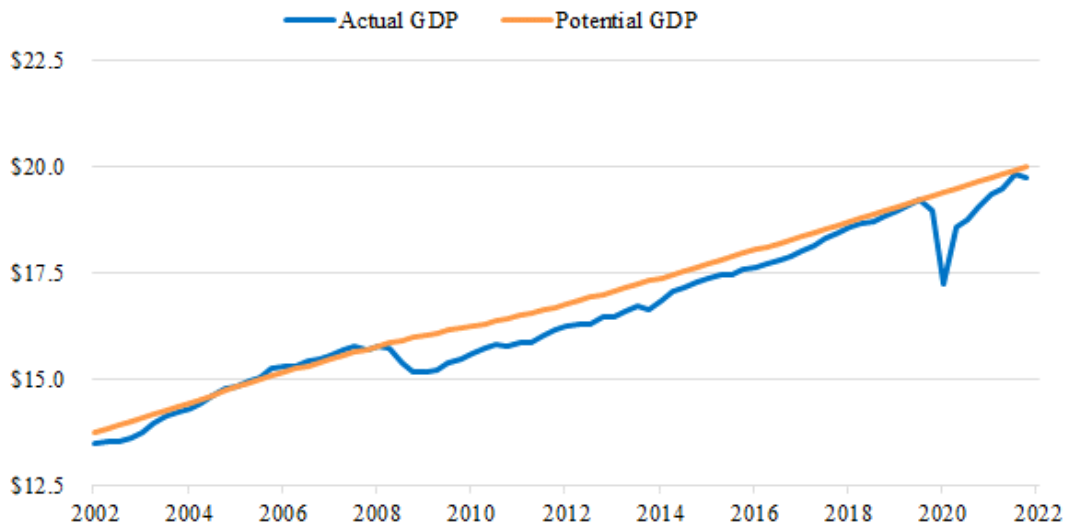


Sources: U.S. Bureau of Economic Analysis and National Bureau of Economic Research. GDP percent change is based on chained 2012 dollars.

The brief 2020 recession caused by the coronavirus pandemic resulted in real GDP in the U.S. to fall to \$17.3 trillion in the first quarter of 2020, which was \$2.1 trillion below the \$19.4 trillion potential real GDP estimated by the Congressional Budget Office. Despite the decline in output in the first quarter of 2022, the economy has reduced this \$2.1 trillion shortfall by approximately 87 percent, to \$0.28 trillion. Actual GDP and potential 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 modest growth in 2022, with GDP growth of 1.7 percent. Thereafter, it projects GDP growth rates of 1.7 percent and 1.9 percent in 2023 and 2024, respectively, before settling at 1.8 percent annual growth for the long-run.

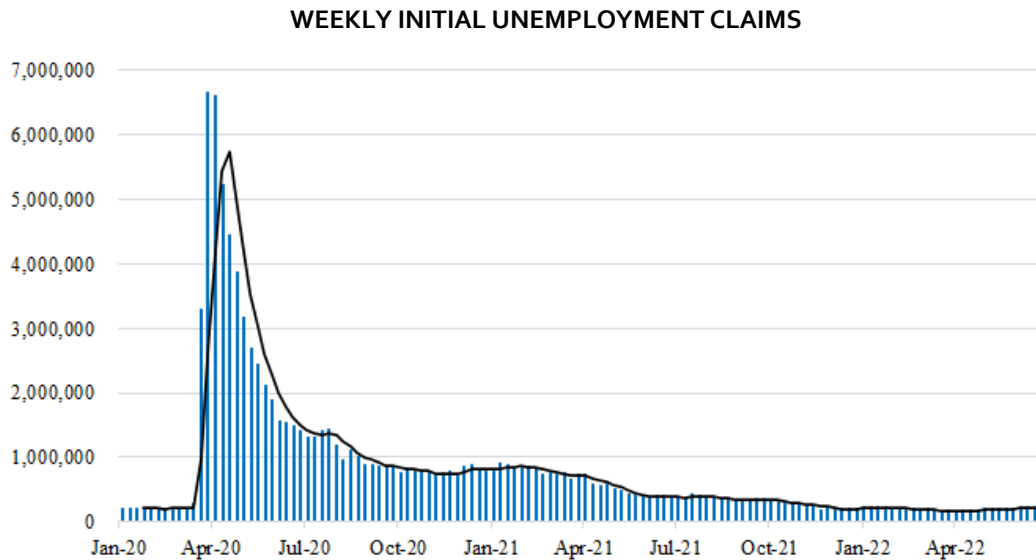
## Employment

From March 2010 (the end of the 2008–2009 recession) to February 2020, 23.2 million net non-farm jobs were created.<sup>4</sup> At the end of the second 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, reached 6.7 percent in June 2022 (its historical low since data was first collected in 1994).<sup>5</sup>

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. As the economy and labor market recovered, initial unemployment claims have remained historically low, averaging 206,000 throughout the second quarter of 2022 compared to an average of 202,000 throughout the first quarter.



Although initial claims have begun trending upward towards the end of the second quarter of 2022, exceeding 230,000 for each week in June, initial claims are still near the lower end of its historical range and signaling an extremely tight labor market despite output growth concerns. Weekly initial unemployment claims and the four-week moving average since the beginning of 2020 are shown in the following figure.

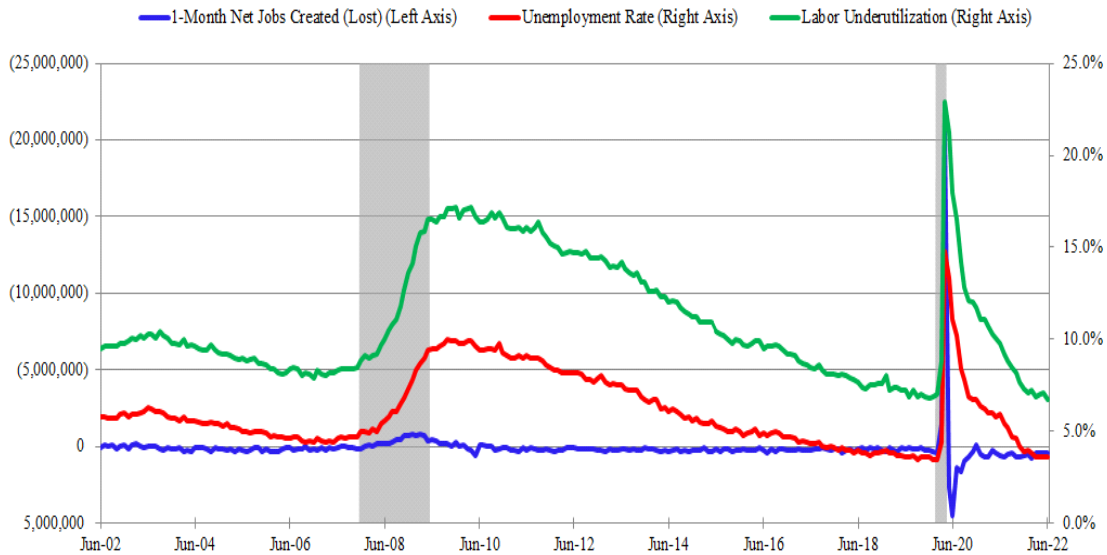


Source: Federal Reserve Bank of St. Louis.

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 May 2022, businesses reported that there were still over 11 million job openings available, while there were only approximately 6 million unemployed people seeking work.<sup>67</sup> In addition, over 4 million workers reportedly quit their jobs in the month of May, a level which has remained near all-time highs in previous months.<sup>8</sup> 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 relative to the number of people seeking work and workers' willingness to quit their current job indicate that labor conditions are remaining strong.

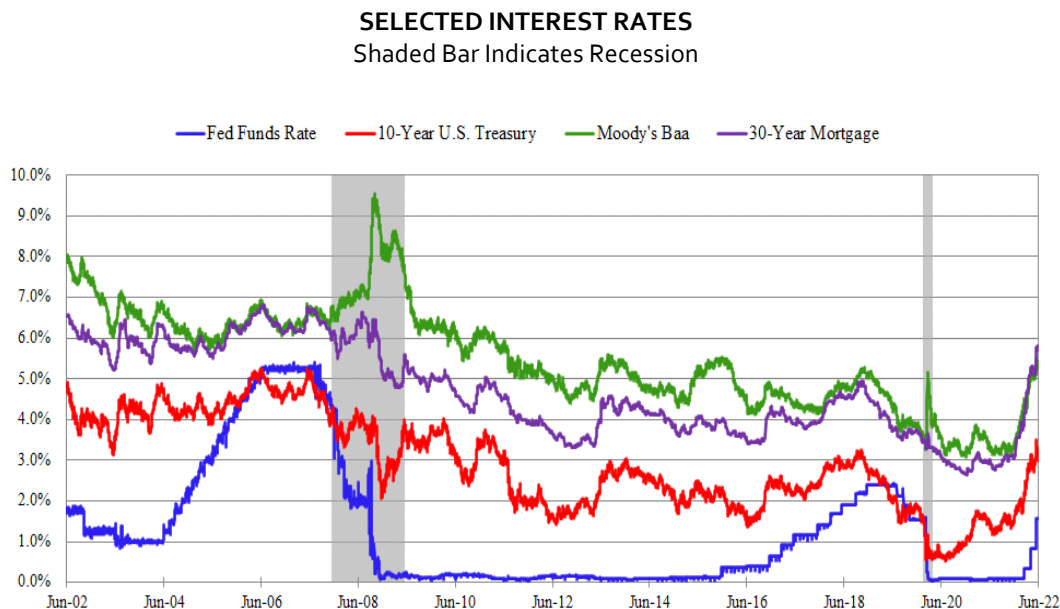
## Interest Rates

Interest rates continued their broad increase during the second quarter of 2022, reaching their highest levels since well before the pandemic and the 2020 recession, as the Committee continues along the path of rate increases.

The yield on the 10-year U.S. Treasury rose 66 basis points by the end of the second quarter to 2.98 percent, which is its highest level since December 2018. The Moody's Baa rate increased by



104 basis points throughout the second quarter to 5.29 percent, a rate that hasn't been topped since March 2016. The 30-year fixed home mortgage rate increased by 103 basis points to 5.70 percent in the second quarter as well, its highest point since December 2008. Interest 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.



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

## Stock Market Activity

All the major indices posted significant negative returns in the second quarter of 2022, following modest negative returns during the first quarter. Volatility remained elevated due to concerns over persistently high inflation and how aggressive the Committee will be in its rate increases to reduce inflation, as well as the ongoing uncertainty surrounding the war between Russia and Ukraine. Investors are particularly concerned how the war is affecting global energy prices, as Russia is a major exporter of oil and gas, and both countries play a significant role in the global market for grains and other foods.

The Dow Jones Industrial Average posted the smallest loss of all the major indices in the second quarter of 2022, as it did in the first quarter. The NASDAQ Composite has been the worst performing index so far in 2022, as technology-based companies are particularly sensitive to rising interest rates and their effect on the valuation of future cash flows. All major indices began the second quarter of 2022 with modest negative returns, which have only accelerated in the past three months, driven primarily by inflation and growth concerns. Total returns for U.S. stock indices are shown in the following figure.



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

Index	Second Quarter 2022	Year to Date
S&P 500	(16.1%)	(20.0%)
Dow Jones Industrial Average	(10.8%)	(14.4%)
NASDAQ Composite (1)	(22.4%)	(29.5%)
S&P MidCap 400	(15.4%)	(19.5%)
Russell 2000	(17.2%)	(23.4%)

*Note:*

(1) Return represents principal only.

## Inflation<sup>9</sup>

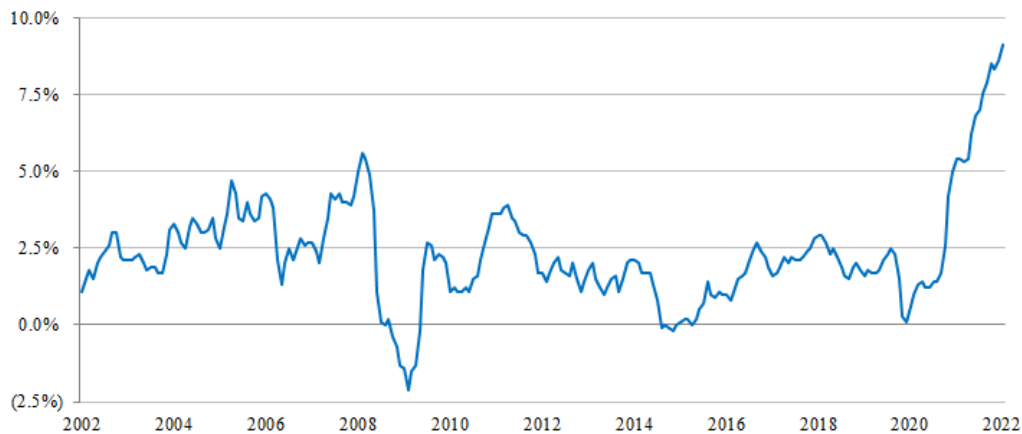
Inflation continued to be the most prevalent topic surrounding the U.S. economy throughout the second quarter of 2022. The subdued global recovery from the coronavirus pandemic continues to disrupt international supply chains, and the Russian invasion of Ukraine has adversely affected global food and energy prices. 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 1.3 percent in the month of June alone, as well as 9.1 percent for the 12 months ending June 2022, which is the highest 12-month increase since November 1981. The price of fuel oil declined by 1.2 percent in June after increasing by nearly 17 percent in May. However, it is still 98 percent higher in June 2022 than one year prior.

Core CPI, which excludes oil and food due to their volatility, increased by 5.9 percent over the 12-month period ending June 2022, which is a decline from the 6.4 percent increase for the 12-month period ending March 2022, but still historically high. Core CPI rose by 0.7 percent in June 2022 alone, which represents its largest increase since June 2021. Although there is optimism that waning consumer demand, gradual improvements to the supply chain, and the actions taken by the Committee will begin to bring down inflation, it is unclear how long it will take or how damaging it will be to the economy for the Federal Reserve to get inflation back to its 2.0 percent target. The items that experienced notable price increases during the month of June include transportation services (2.1 percent), new and used vehicles (0.7 percent and 1.6 percent, respectively), food (1.0 percent), and apparel (0.8 percent).

The last time inflation was comparable to our current environment was the early 1980s, which exhibited some of the issues being experienced today; global and political instability, as well as energy and oil shocks. However, the current inflationary environment is particularly surprising given how muted inflation had been for the past two decades. Since 2002, inflation had only reached 5.0 percent for a brief period in 2008, and had since failed to exceed 4.0 percent until April 2021. The annual change in the CPI for the last 20 years 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 second 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 future inflation. Prior to 2020, one-year forward-looking inflation expectations generally remained between 2.5 percent and 3.0 percent since 2015. In 2022, one-year forward-looking inflation expectations have increased from 6.6 percent in May to 6.8 percent in June. In addition, three-year forward looking inflation expectations remain elevated above the Committee's longer run 2.0 percent target, with current expectations of just under 4.0 percent.<sup>10</sup>

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 June meeting, the members of the Committee provided their outlook of the target range for the federal funds rate in the coming years. The members are in agreement that the target range for the federal funds rate will be at least 3.0 percent by the end of 2022, with all but one member expecting the target range to increase further by the end of 2023, and five members projecting a target range above 4.0 percent. In 2024, there is a greater variance of projections for the target range, with the majority of the members indicating an appropriate range somewhere between 3.0 percent and 3.5 percent; however, some members believe an appropriate target range could be as low as 2.0 percent or as high as 4.0 percent. In the longer run, all of the Committee members indicate a target range somewhere between 2.0 percent and 3.0 percent is likely.<sup>11</sup>





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 5.2 percent and Core PCE inflation of 4.3 percent. In the years to follow, the Federal Reserve expects inflation to retreat to more moderate levels. It projects PCE inflation of 2.6 percent and 2.2 percent in 2023 and 2024, respectively, supporting its belief that the Committee’s policies will not allow the inflationary environment to exist long-term.<sup>12</sup>



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/research/data/us-business-cycle-expansions-and-contractions>>.
2. Ibid.
3. Board of Governors of the Federal Reserve System, "Plans for Reducing the Size of the Federal Reserve's Balance Sheet", May 4, 2022.  
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4. 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](http://data.bls.gov/timeseries/CES0000000001?output_view=net_1mth)>.
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.
6. Bureau of Labor Statistics, "Job Openings and Labor Turnover - May 2022," July 6, 2022,  
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7. Bureau of Labor Statistics, "The Employment Situation - May 2022," June 3, 2022,  
<<https://www.bls.gov/bls/news-release/empsit.htm>>.
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11. Board of Governors of the Federal Reserve System, "Summary of Economic Projections," June 15, 2022, <<https://www.federalreserve.gov/monetarypolicy/fomcproptabl20220615.htm>>.
12. Ibid.