Economic Review - Second Quarter 2023

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. After returning to growth in April 2020, the U.S. economy rapidly recovered, adding back nearly 10 million jobs in the final 8 months of 2020. Since the beginning of 2021, the U.S. economy has added back an additional 16 million jobs through the first half of 2023, representing a cumulative gain of nearly 26 million jobs in the 38 months since April 2020.

Summary

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.[1] 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.[2] After returning to growth in April 2020, the U.S. economy rapidly recovered, adding back nearly 10 million jobs in the final 8 months of 2020. Since the beginning of 2021, the U.S. economy has added back an additional 16 million jobs through the first half of 2023, representing a cumulative gain of nearly 26 million jobs in the 38 months since April 2020.

The Federal Open Market Committee (the "Committee") of the Federal Reserve held two meetings during the second quarter of 2023; 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 25 basis points in May; representing a change in the target range from 4.75 percent-to-5.00 percent to 5.00-to-5.25 percent.

- Holding the target range steady at 5.00-to-5.25 percent at its June meeting.

- Consideration of the aggregate effect of the Committee's previous actions in the tightening of monetary policy when determining the appropriateness of future policy decisions. The Committee expects the effects of previous rate increases to be working with a lag throughout the economy.

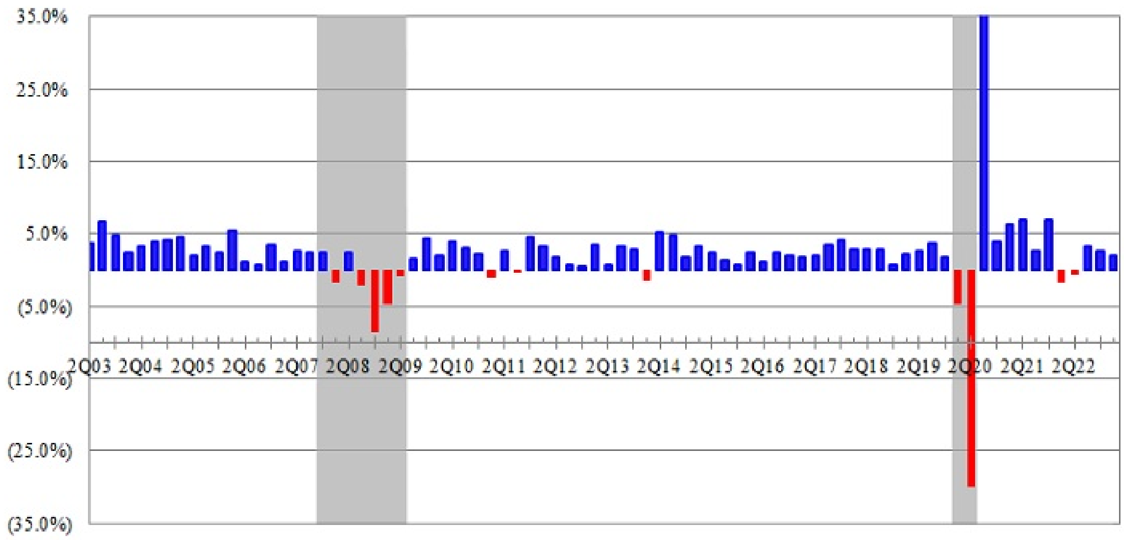
- Continuing its reduction of the assets held on the Federal Reserve's balance sheet by $95 billion per month. [3]

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 2.0 percent in the first quarter of 2023; which is the third consecutive quarter of growth following successive declines in the first and second quarters of 2022. In 2022, GDP increased by 2.1 percent for the year, compared to a 5.9 percent increase in 2021. Quarterly GDP data for the preceding 20 years is shown in the following figure.

QUARTERLY U.S. GDP GROWTH

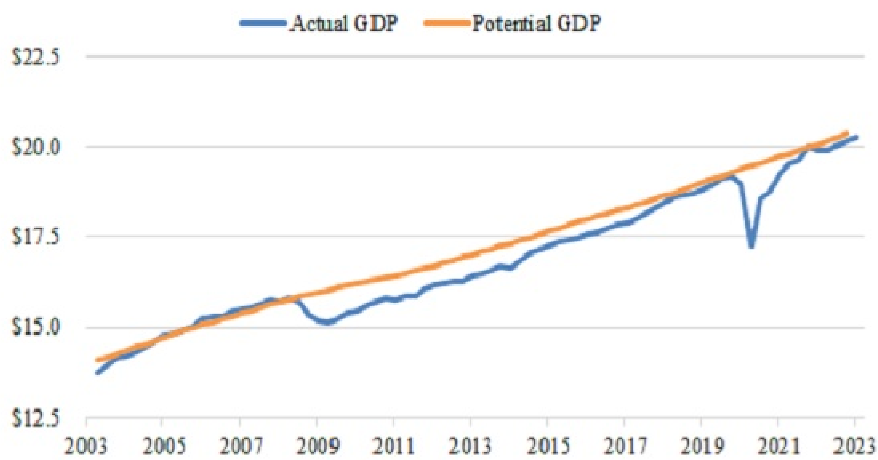
Seasonally Adjusted Annualized Rates; Shaded Bar Indicates Recession



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 coronavirus pandemic resulted in real GDP in the U.S. to fall to $17.3 trillion in the first quarter of 2020, which was $2.2 trillion below the $19.5 trillion potential real GDP estimated by the Congressional Budget Office. After actual GDP briefly exceeded potential GDP in the fourth quarter of 2021, the declines in output in the first two quarters of 2022 brought upon a shortfall of $0.28 trillion between actual and potential GDP. The growth in actual GDP in the second half of 2022 and the first quarter of 2023 has tightened this deficit to $0.17 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 projects modest GDP growth of 1.0 percent for 2023. Thereafter, it projects GDP growth of 1.1 percent in 2024 before settling at 1.8 percent growth for 2025 and the long-run.

Employment

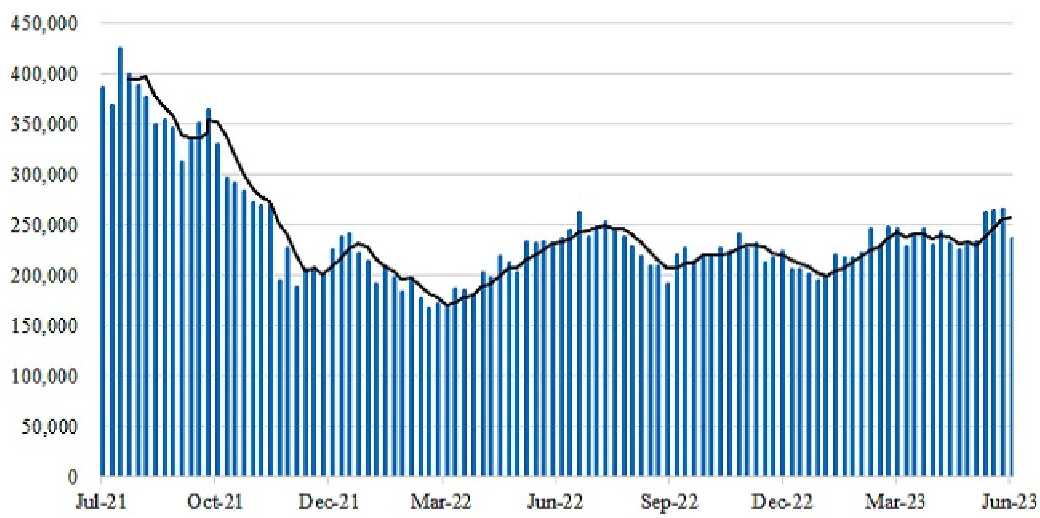
From March 2010 (the end of the 2008–2009 recession) to February 2020, 23.2 million net non-farm jobs were created.[4] After the brief recession caused by the coronavirus pandemic eliminated ten years of job growth in just a few months, the economy returned to its pre-pandemic levels of employment in June 2022. In the second quarter of 2023 alone, an additional 732,000 jobs were added. The unemployment rate reached a second quarter-low of 3.4 percent in April, which matches the level recently achieved in January 2023 and the 54-year low of 3.4 percent reached 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, has elevated from 6.5 percent in December 2022 (an all-time low since data was first collected in 1994) to 6.9 percent in June 2023.[5]

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, increasing slightly to an average of 241,000 throughout the second quarter of 2023 compared to an average of 220,000 throughout the first quarter of 2023.

After initial claims fluctuated between approximately 225,000 and 245,000 in April and May of 2023, they peaked at 265,000 for the week ending June 17, 2023, its highest level since the week ending November 13, 2021 (270,000). After exceeding 260,000 for each of the first three weeks in June, initial claims ended the second quarter at 236,000 for the week ending June 24, 2023. Initial claims are still near the lower end of its historical range and continue to signal an extremely tight labor market despite recession and inflation concerns. Weekly initial unemployment claims and the four-week moving average for the past two years are shown in the following figure.

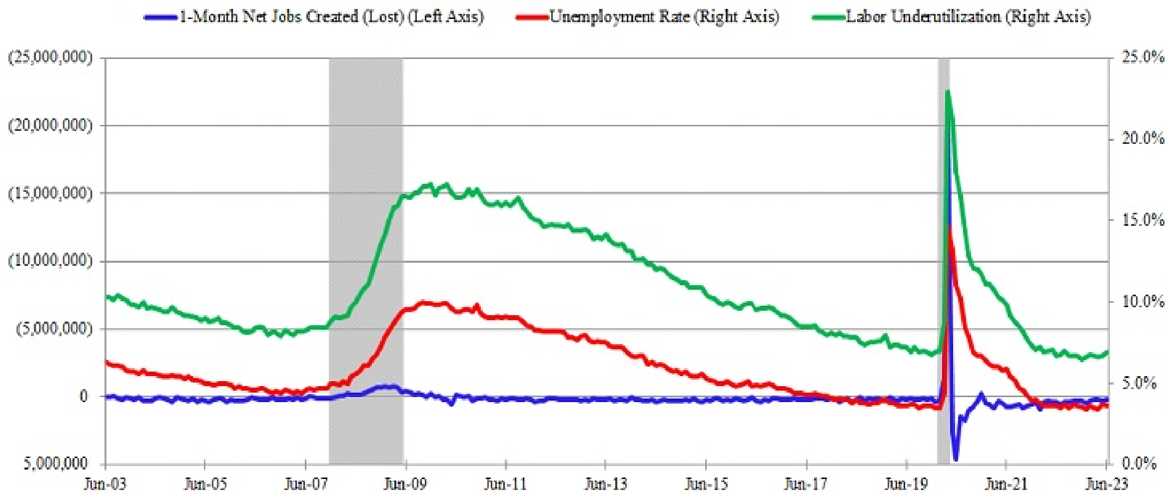
WEEKLY INITIAL UNEMPLOYMENT CLAIMS



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.

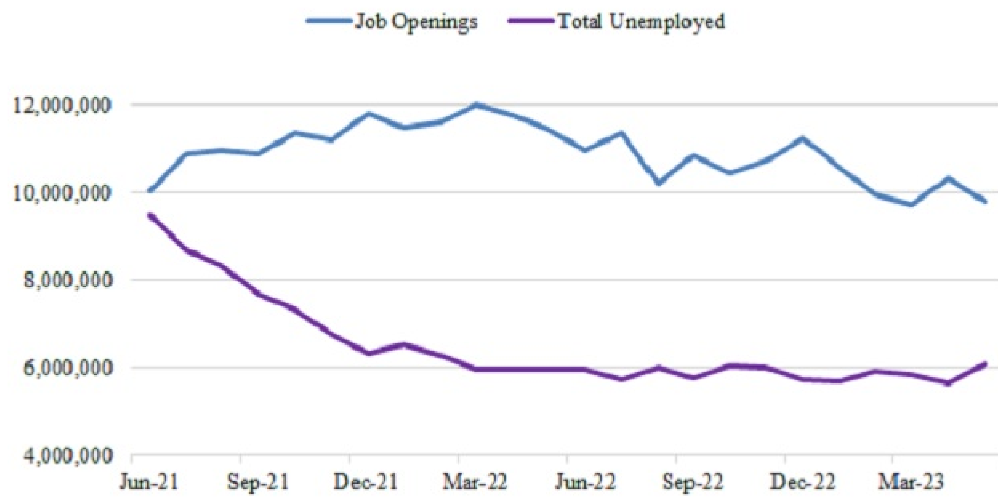
MEASURES OF STRESS IN THE LABOR MARKET
Shaded Bar Indicates Recession



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

While the labor market has remained strong in recent quarters, there is still a large mismatch between the number of people actively looking for work and the number of unfilled job openings. As of May 2023, there were approximately 6.1 million unemployed people seeking work, while businesses reported that there were more than 9.8 million job openings.[6,7] While this gap has narrowed slightly in recent quarters, the surplus of job openings relative to job seekers suggests a favorable labor market for workers, and strong demand for labor from employers. The relationship between job openings and the total number of people who are unemployed and seeking work for the past two years is shown in the following figure.

JOB OPENINGS COMPARED TO TOTAL UNEMPLOYED
(Amounts in Whole Numbers)



Source: Federal Reserve Bank of St. Louis.

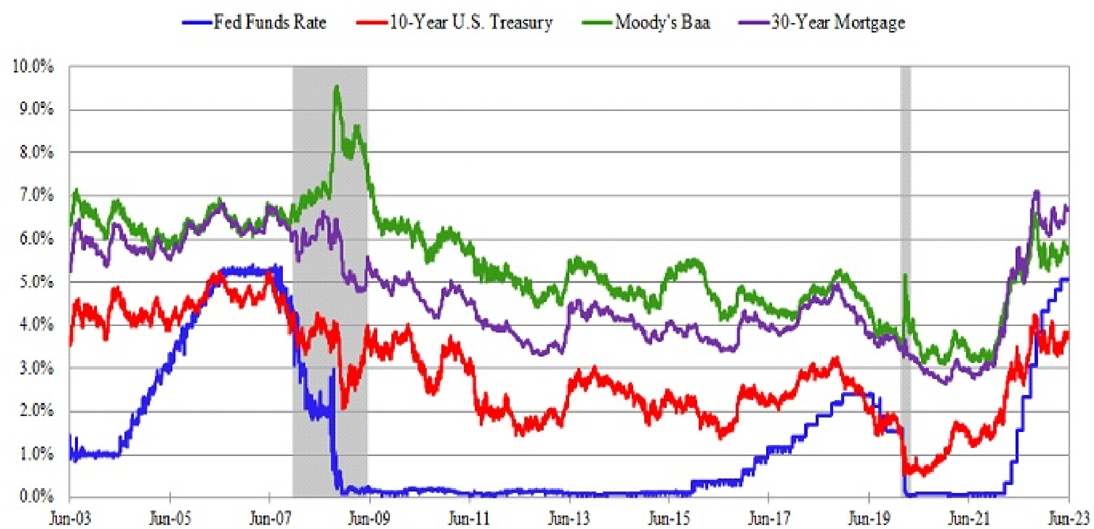
In addition, nearly 4 million workers reportedly quit their jobs in the month of May, a level which has moderated somewhat over the past year, but is considered to still be historically high.[8] The higher the rate at which workers quit is generally viewed as a positive sign for the labor market, as 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

Following the Committee's decision to further raise the federal funds rate in the second quarter of 2023, interest rates increased as well and remained near recent highs. However, given improving inflation data, there is a belief that the Committee may be nearing the completion of its rate increase cycle, and therefore interest rates may be reaching their peaks. In other words, investors believe the federal funds rate may be reaching its "terminal" level, which is the point at which inflation can continue to moderate towards the 2.0 percent target without further hindering growth.

The yield on the 10-year U.S. Treasury increased 33 basis points in the second quarter to 3.81 percent, which is still below the 12-year high of 4.24 percent reached in the fourth quarter of 2022. The Moody's Baa rate increased by 10 basis points to 5.69 percent in the second quarter, while the 30-year fixed home mortgage rate increased by 39 basis points to 6.71 percent over the same period; both of which are below their recent peaks seen in the fourth quarter of 2022. Interest rates are likely to continue to closely follow the actions and outlook provided by the Committee. 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 indices continued their recovery from poor returns in 2022 with a strong performance so far in 2023, largely fueled by consistently positive data regarding inflation and employment, as well as hopes the Committee is nearing the end of its rate-increase cycle. The NASDAQ Composite continued to be the best performing U.S. index so far in 2023, as technology-related stocks benefit the most from the prospects of interest rates stabilizing. All the other major indices posted single-digit gains during the second quarter.

Volatility continued to decline throughout the second quarter of 2023. This unusually calm period in the market is a deviation from the volatility broadly experienced in recent years since the onset of the coronavirus pandemic. Generally positive economic data, along with the improving outlook on inflation, helped calm investors and market participants. Further, as more positive data comes in, concerns surrounding whether there will be a recession in the near-term are becoming less pervasive; both in regards to whether we will actually enter a recession, and about how impactful and long-lived one may be.

The NASDAQ Composite and the Dow Jones Industrial Average were the best and worst performing indices of the second quarter and year-to-date, respectively. The S&P 500 effectively split the difference between these two indices, benefitting from the aforementioned positive economic news that came in during the quarter. The S&P MidCap 400 and the Russell 2000 narrowly outpaced the Dow Jones Industrial Average, but lagged behind the larger cap indices that were fueled by strong returns of the larger technology-based companies; such as Apple, Meta (Facebook) and Nvidia .

The belief that the Committee is nearing the end of its aggressive rate hike program, coupled with positive data on inflation, output, and employment, is good for all participants in the market. As a result, all the U.S. stock indices posted positive returns in the second quarter. Total returns for U.S. stock indices are shown in the following figure.

TOTAL RETURNS OF MAJOR U.S. STOCK INDICES

Index	**Second Quarter 2023**	**Year to Date**
S&P 500	8.7%	16.9%
Dow Jones Industrial Average	4.0%	4.9%
NASDAQ Composite (1)	12.8%	31.7%
S&P MidCap 400	4.9%	8.8%
Russell 2000	5.2%	8.1%

Note:
(1) Return represents principal only.

Inflation[9]

Inflation continued to be the most prevalent topic surrounding the U.S. economy throughout the second quarter of 2023. 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). Following a lack of significant declines throughout 2022 and the first two months of 2023, the 12-month change in the consumer price index ("CPI") markedly declined from 5.0 percent in March to 3.0 percent in June, its lowest 12-month increase since March 2021. By contrast, the 12-month change had only dropped from 7.5 percent to 6.0 percent from January 2022 to February 2023.

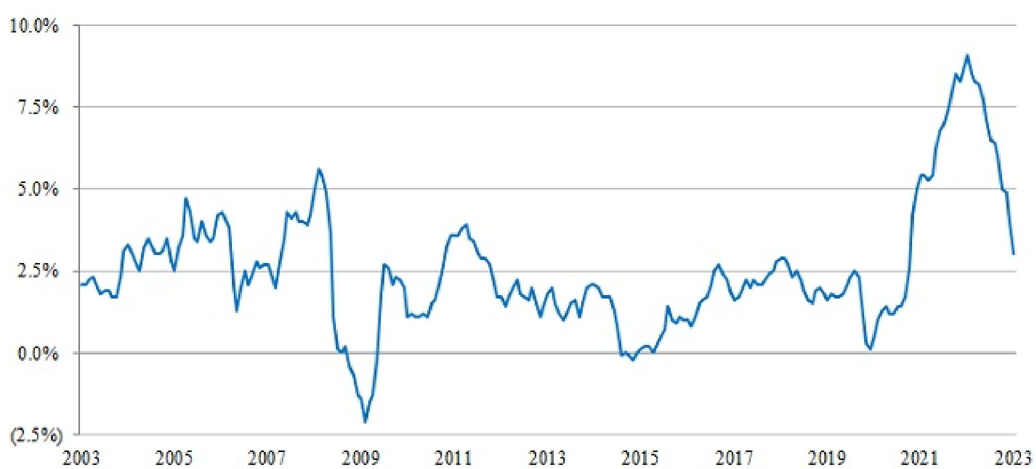
For the month of June alone, CPI increased by 0.2 percent, which was largely driven by increases in energy prices, apparel, and shelter. Energy prices posted their first monthly increase in 2023, increasing by 0.6 percent in June. However, overall energy prices still stand at nearly 17 percent lower in June 2023 than one year prior. While the one-month change in CPI remains somewhat volatile, it is much lower than the one-month increases predominantly experienced since the beginning of 2021.

Core CPI, which excludes oil and food due to their volatility, increased by 4.8 percent over the 12-month period ending June 2023, which continues to remain stubborn and little changed from the 5.9 percent increase for the 12-month period ending June 2022, signaling that inflation for main goods and services remains high. Core CPI rose by 0.2 percent in June 2023 alone, which its smallest increase since August 2021.

Some of the notable items that experienced meaningful price changes in the month alone include gasoline (1.0 percent), electricity (0.9 percent), shelter (0.4 percent), and apparel (0.3 percent). For the 12 months ending June 2023, the price increases on transportation (8.2 percent), shelter (7.8 percent), and food (5.7 percent), were significant as well.

As the inflationary outlook continues to improve in 2023, it is noticeable how sticky inflation has turned out to be for everyday items and services. While the 12-month change in CPI falling to 3.0 percent is certainly welcomed news, it is largely being distorted by steep declines in energy prices which were significantly higher at this point last year. Many typical goods and services that consumers purchase on a consistent basis; such as food, clothing, and transportation, remain elevated and well beyond the Committee's 2.0 percent target. This reality is reflected in the aforementioned lack of progress made in the reduction of the 12-month change in the Core CPI over the last year, and is significantly beyond its pre-pandemic levels. This indicates that price pressures are still pervasive throughout the economy and that the Committee may need to elevate interest rates further and hold them at those higher levels for longer; which will likely have adverse impacts on financial markets and the broader economy. 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 reduction in the pace of inflation in recent months, inflation expectations are beginning to reflect that optimism among consumers. 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. One-year forward-looking inflation expectations have continued to decrease from a high of 6.8 percent in June 2022 to 3.8 percent in June 2023; its lowest level since April 2021 and an overall positive sign that the Committee's actions and incoming data are indicative of progress towards price stability, at least in the eyes of consumers. In addition, three-year forward looking inflation expectations remain elevated above the Committee's longer run 2.0 percent target, but have declined over the past year from 3.6 percent to 3.0 percent as of June 2023. [10]

The Committee has continued to adjust its stance as the outlook of inflation changes over time based on new economic data. 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 predict that the target range for the federal funds rate will be between 5.0 percent and 6.25 percent by the end of 2023. In 2024, there is a wide variance of projections for the target range, ranging from as low as 3.50 percent to as high as 6.0 percent. However, the bulk of the members see a target range between 4.25 percent and 5.25 percent. In the longer run, a significant majority of the Committee members indicate a target range somewhere between 2.25 percent and 3.00 percent is appropriate. [11]

The Federal Reserve publishes estimates of personal consumption expenditures ("PCE") inflation and Core PCE inflation. It projects PCE inflation of 3.2 percent and Core PCE inflation of 3.3 percent in 2023. In the years to follow, the Federal Reserve expects inflation to retreat to more moderate levels. It projects PCE and Core PCE inflation of 2.5 percent and 2.6 percent respectively, in 2024; followed by PCE and Core PCE inflation of 2.1 percent and 2.2 percent, respectively, in 2025. This supports the Committee's belief its policies will not allow the inflationary environment to exist long-term. [12]

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. <https://www.federalreserve.gov/newsevents/pressreleases/monetary20220504b.htm>.

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>.

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, "The Employment Situation - May 2023," June 2, 2023, <https://www.bls.gov/news.release/archives/empsit_06022023.htm>.

7. Bureau of Labor Statistics, "Job Openings and Labor Turnover - May 2023," July 6, 2023, <https://www.bls.gov/news.release/archives/jolts_07062023.htm>.

8. Ibid.

9. Bureau of Labor Statistics, "Consumer Price Index - June 2023," July 12, 2023, <https://www.bls.gov/news.release/cpi.nr0.htm>.

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

11. Board of Governors of the Federal Reserve System, "Summary of Economic Projections," June 14, 2023, <https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20230614.htm>.

12. Ibid.