Economic Review - Third 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 17 million jobs through the third quarter of 2023, representing a cumulative gain of more than 26 million jobs in the 41 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 17 million jobs through the third quarter of 2023, representing a cumulative gain of more than 26 million jobs in the 41 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 July and one in September 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 July; representing a change in the target range from 5.00-to-5.25 percent to 5.25-to-5.50 percent.

- Holding the target range steady at 5.25-to-5.50 percent at its September meeting.

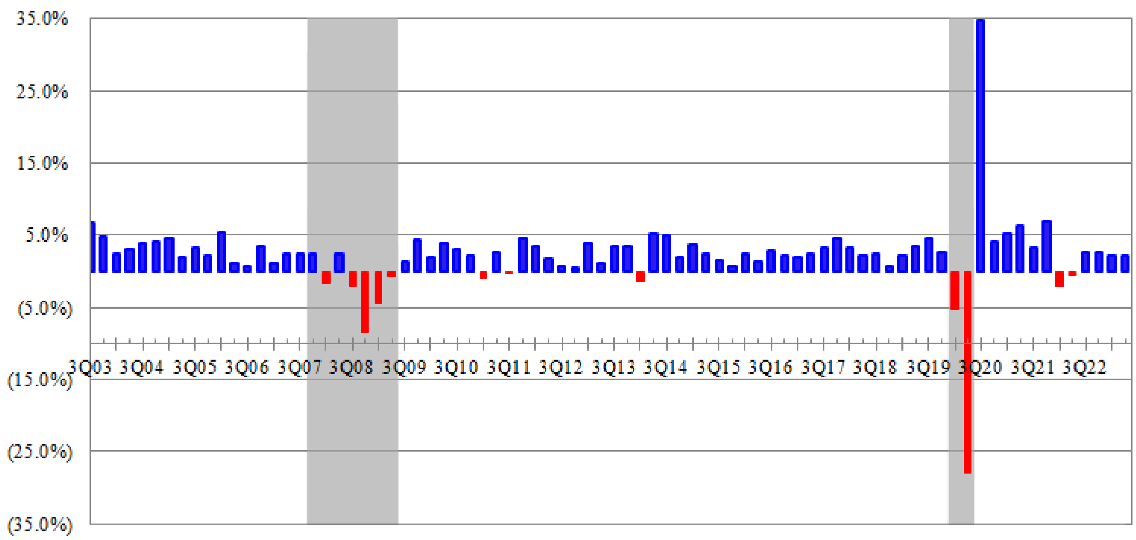
- Consideration of the aggregate effect of the Committee's previous actions in the tightening of monetary policy when determining the appropriateness of future policy decisions. The Committee expects the effects of previous rate increases to be working with a lag throughout the economy.

- 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 2.1 percent in the second quarter of 2023; which is the fourth 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.

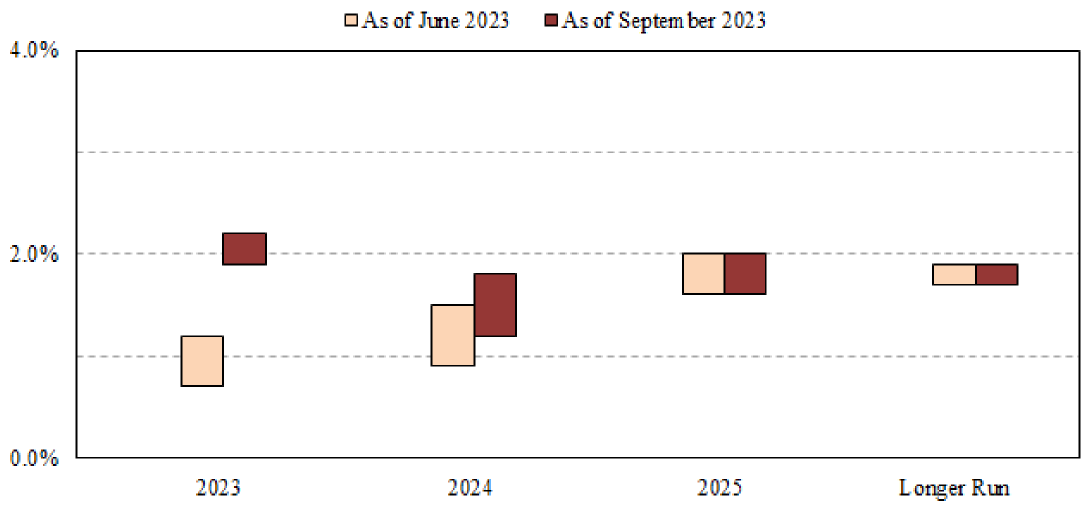
QUARTERLY U.S. GDP GROWTH
Seasonally Adjusted Annualized Rates; Shaded Bar Indicates Recession



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

The Federal Reserve projects GDP growth of 2.1 percent for 2023. Thereafter, it projects GDP growth of 1.5 percent in 2024 before settling at 1.8 percent growth for 2025 and the long-run. The projected GDP growth rates in the near-term have improved from the June projections, but remain unchanged in the longer term. The Committee's projections of GDP growth are presented in the following figure.

U.S. GDP GROWTH ESTIMATES



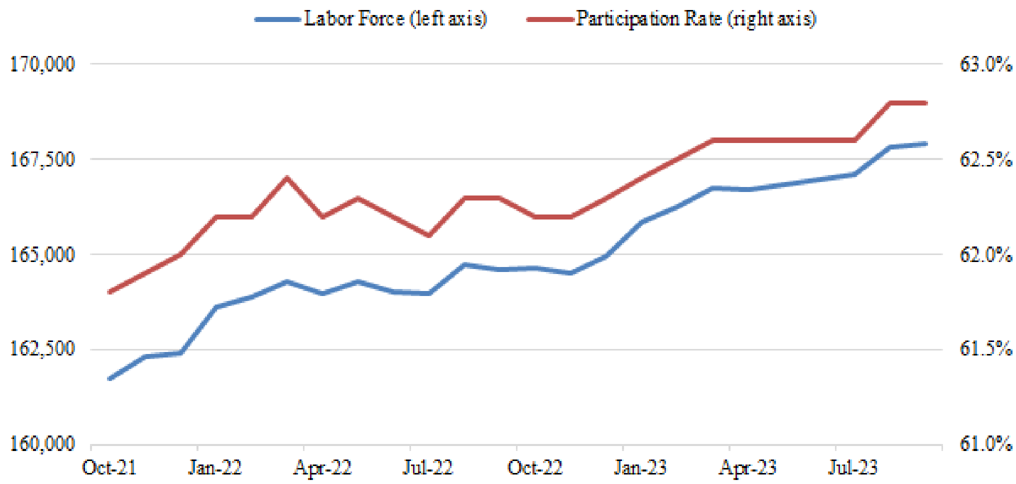
Sources: Federal Reserve.

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 third quarter of 2023 alone, nearly 800,000 jobs were added. Despite the strong growth in jobs, the unemployment rate increased from 3.6 percent to 3.8 percent by the end of the third quarter, its highest level since January 2022.

The increase in the unemployment rate is primarily due to the growth in the labor force and people actively looking for work, which are classified as "unemployed". In the third quarter, an additional million people entered the labor force; representing an increase in the labor force participation rate from 62.6 percent to 62.8 percent from June to September.[5] The number of civilians in the labor force and the participation rate have continued to improve following the effects of the coronavirus pandemic. The labor force and labor force participation rate for the last two years are shown in the following figure.

U.S. LABOR FORCE AND PARTICIPATION RATE
(Amounts in Thousands and Percentages)



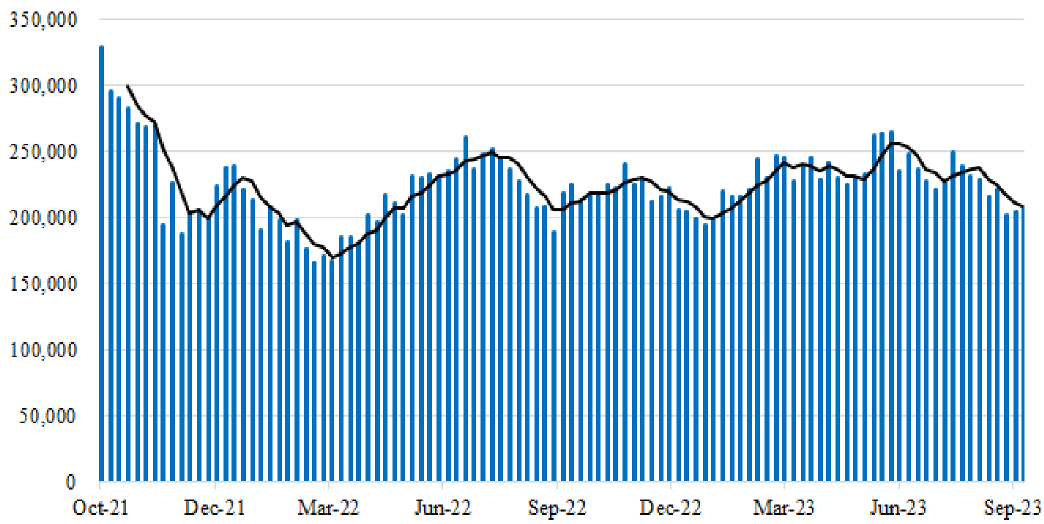
Source: Federal Reserve Bank of St. Louis.

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 6.9 percent in December 2022 to 7.0 percent in September 2023.[6]

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, decreasing slightly to an average of 226,000 throughout the third quarter of 2023 compared to an average of 241,000 throughout the second quarter of 2023.

After initial claims peaked at 250,000 for the week ending August 5, 2023, they began a steady decline for the rest of August and September, ending the third quarter at 209,000 for the week ending September 30, 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.

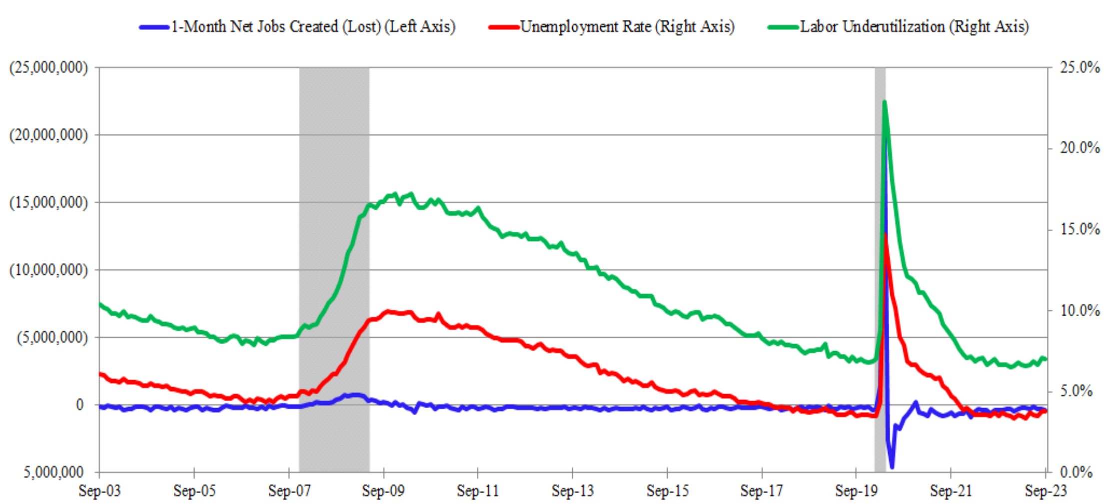
WEEKLY INITIAL UNEMPLOYMENT CLAIMS



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.

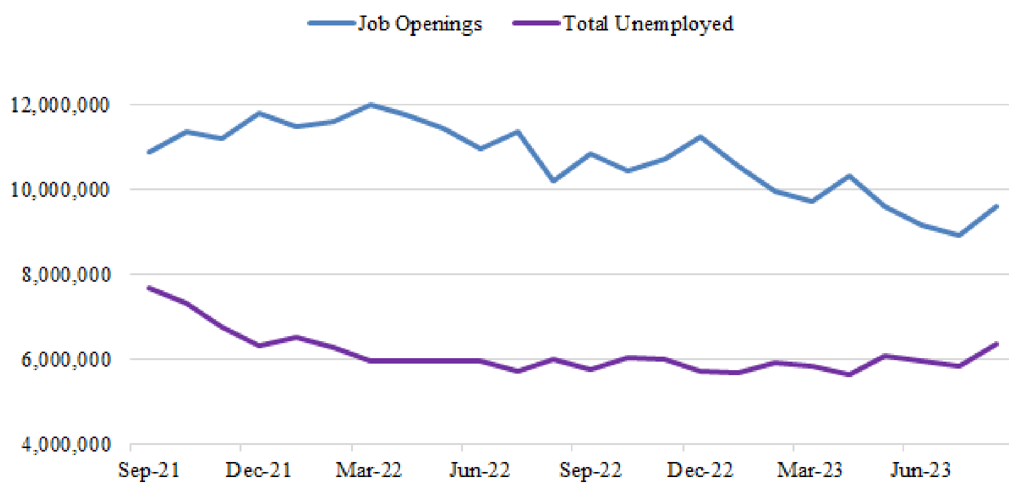
MEASURES OF STRESS IN THE LABOR MARKET
Shaded Bar Indicates Recession



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 August 2023, there were approximately 6.4 million unemployed people seeking work, while businesses reported that there were more than 9.6 million job openings.[7, 8] 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.

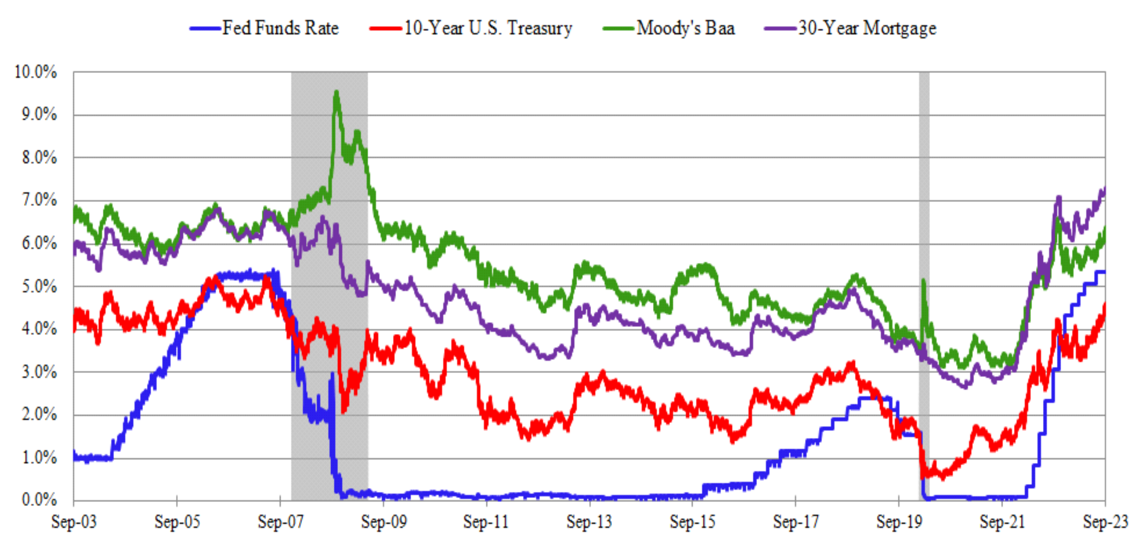
In addition, about 3.6 million workers reportedly quit their jobs in the month of August, a level which has continued to moderate over the past year, but is considered to still be historically high.[9] The higher the rate at which workers quit is generally viewed as a positive sign for the labor market, 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 third quarter of 2023, interest rates increased as well and remain near their recent highs. However, given improving inflation data, there is a belief that the Committee is likely nearing the end 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 78 basis points in the third quarter to 4.59 percent, which is its highest level since October 2007. The Moody's Baa rate increased by 68 basis points to 6.37 percent in the third quarter, which is below its recent peak seen in the fourth quarter of 2022. The 30-year fixed home mortgage rate increased by 60 basis points to 7.31 percent, its highest level since December 2000. 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

Following a widespread strong performance in the first half of 2023, all the major indices posted modest declines in the third quarter, primarily due to uncertainty regarding the Committee's trajectory of future interest rate hikes, along with mixed economic data. The Dow Jones Industrial

Average declined the least among the U.S. indices during the third quarter, as the industrial companies which make up the majority of the index are less sensitive to changes in interest rates. All the major indices posted single-digit losses during the third quarter.

Volatility remained relatively subdued in the third quarter of 2023, compared to the excessive volatility broadly experienced in recent years since the onset of the coronavirus pandemic and the ensuing inflationary environment. The largely neutral economic data reported during the third quarter, along with the improving outlook on inflation, kept investors and market participants relatively calm. Further, as more economic 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 Russell 2000 was the worst performing index of the third quarter and year-to-date. Despite lagging behind the S&P 500 and the Dow Jones Industrial Average during the third quarter, the NASDAQ Composite is still the best performing index year-to-date, fueled by the strong performance in the first half of the year by the larger technology-based companies; such as Apple, Meta (Facebook), and Nvidia. Total returns for U.S. stock indices are shown in the following figure.

TOTAL RETURNS OF MAJOR U.S. STOCK INDICES

Index	**Third Quarter 2023**	**Year to Date**
S&P 500	(3.3%)	13.1%
Dow Jones Industrial Average	(2.1%)	2.7%
NASDAQ Composite (1)	(4.1%)	26.3%
S&P MidCap 400	(4.2%)	4.3%
Russell 2000	(5.1%)	2.5%

Note:
(1) Return represents principal only.

Inflation[10]

Inflation continued to be the most prevalent topic surrounding the U.S. economy throughout the third 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 significant decline in the second quarter of 2023, the 12-month change in the consumer price index ("CPI") increased in July and August, and remained unchanged in September; ultimately increasing from 3.0 percent in June to 3.7 percent in September. The increases in July and August broke a streak of 12 straight months with a decline in the 12-month change in the CPI, which last increased in June 2022.

For the month of September alone, the CPI increased by 0.4 percent, which was largely driven by increases in energy prices, transportation, and shelter. After declining for much of the first half of the year, energy prices have increased in each of the last four months, including monthly increases of 5.6 percent and 1.5 percent in the months of August and September, respectively. Despite the recent growth, overall energy prices are largely unchanged from a year prior, standing at 0.5 percent lower in September 2023. While the one-month changes in the CPI of 0.6 percent in August and 0.4 percent in September are notable increases from what has been experienced for the majority of the past year, the main driver is the aforementioned growth in energy prices, which often exude volatility resulting from non-economic factors.

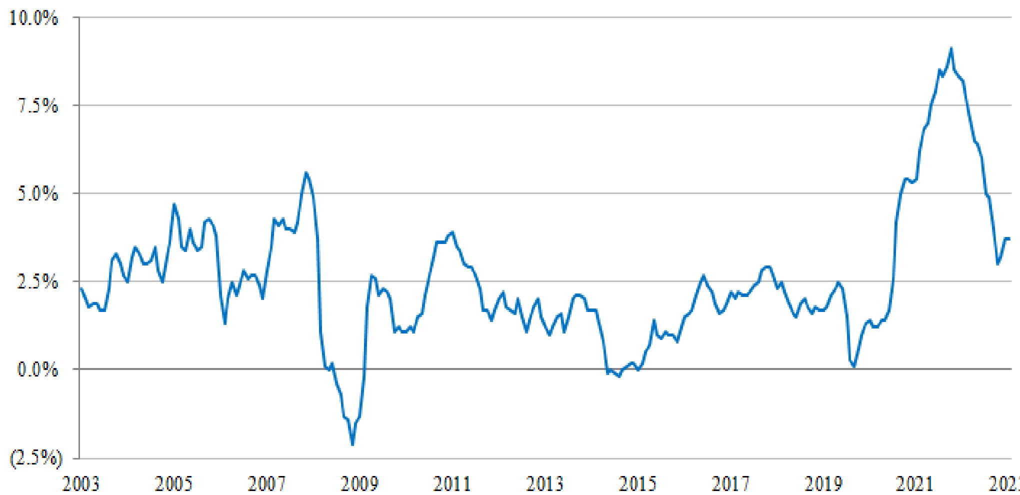
Core CPI, which excludes oil and food due to their volatility, increased by 4.1 percent over the 12-month period ending September 2023, which continues to slowly decline from the 6.6 percent increase for the 12-month period ending September 2022, signaling that inflation for main goods and services remains elevated, but is improving. Core CPI rose by 0.3 percent in September 2023 alone, which is largely in line with the monthly increases experienced so far in 2023.

Some of the notable items that experienced meaningful price changes in the month alone include fuel oil (8.5 percent), gasoline (2.1 percent), transportation (0.7 percent), and shelter (0.6 percent). For the 12 months ending September 2023, the price increases on transportation (9.1 percent), shelter (7.2 percent), medical care (4.2 percent), and food (3.7 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 the Core CPI is continuing its downward trend, it is still approximately double the Committee's 2.0 percent target. Many typical goods and services that consumers purchase on a consistent basis, such as food, clothing, and transportation, remain elevated. This reality is reflected in the 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.

While the Committee has stated it will allow the aggregate impacts of its policy decisions to ripple through the economy for the time being, it remains unclear whether interest rates will need to be increased further, or if they will need to be held at or near their current levels for a longer period of time in order to trim inflation towards the 2.0 percent target, 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



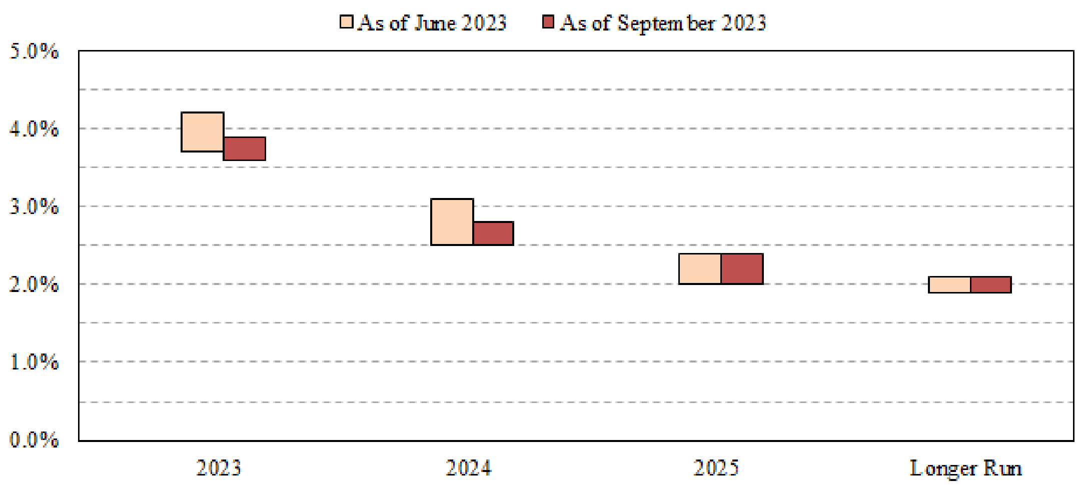
Source: Bureau of Labor Statistics.

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 3.7 percent in September 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 has declined in 2021 and 2022, and has remained between 2.7 percent and 3.0 percent throughout 2023.[11]

The Committee has recently confirmed its intent to adjust its policies accordingly for the purpose of achieving stable prices. At its September meeting, the members of the Committee provided their outlook of the target range for the federal funds rate in the coming years. Every member expects the target range for the federal funds rate will be between 5.25 percent and 5.75 percent by the end of 2023. In 2024, there is a range of projections for the target range, with all but four members projecting a federal funds rate between 4.5 percent and 5.5 percent. In 2025, there is a much wider variance among the members, with projections ranging from as low as 2.5 percent to as high as 5.75 percent. However, 10 of the 19 members expect an appropriate federal funds rate to be between 3.25 percent and 4.25 percent. In the longer run, a significant majority of the Committee members indicate a target range somewhere between 2.25 percent and 2.75 percent is appropriate.[12]

The Federal Reserve publishes estimates of personal consumption expenditures ("PCE") inflation and Core PCE inflation. It projects PCE inflation of 3.3 percent and Core PCE inflation of 3.7 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 2.2 percent and 2.3 percent, respectively, in 2025. This supports the Committee's belief its policies will not allow the inflationary environment to exist long-term.[13] The Committee's projections of Core PCE inflation is presented in the following figure.

CORE PCE ESTIMATES



Source: Federal Reserve.

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. FRED Economic Data, Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/>.

6. "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.

7. Bureau of Labor Statistics, "The Employment Situation - August 2023," September 1, 2023, <https://www.bls.gov/news.release/archives/empsit_09012023.htm>.

8. Bureau of Labor Statistics, "Job Openings and Labor Turnover - August 2023," October 3, 2023, <https://www.bls.gov/news.release/archives/jolts_10032023.htm>.

9. Ibid.

10. Bureau of Labor Statistics, "Consumer Price Index - September 2023," October 12, 2023, <https://www.bls.gov/news.release/cpi.nro.htm>.

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

12. Board of Governors of the Federal Reserve System, "Summary of Economic Projections," September 20, 2023, <https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20230920.htm>.

13. Ibid.