U.S. ECONOMIC OUTLOOOK

FOURTH QUARTER 2021

CURRENT ECONOMIC CONDITIONS COMMENTARY

The Federal Reserve publishes a report (known as the Beige Book) eight times per year that summarizes current economic conditions throughout the 12 Federal Reserve Districts in the United States. The last Beige Book publication of 2021, released on December 1, 2021, noted the following observations:

- Economic activity grew at a modest to moderate pace during October and early November 2021.
- Several Districts noted that despite strong demand, growth was constrained by supply chain disruptions and labor shortages. For example, construction and manufacturing activity generally increased but were held back by scarce materials and labor.
- Consumer spending increased modestly, but low inventories held back sales of some items and high freight volumes continued to strain distribution systems.
- Loan demand increased in almost all Districts, though some reported declines in residential mortgages as residential real estate activity increased in some Districts but decreased in others. Nonresidential real estate activity increased widely across all Districts.
- Leisure and hospitality activity picked up overall as the spread of the Delta variant ebbed in many areas.

The outlook for overall activity remained positive in most Districts, but some noted uncertainty about when supply chain and labor supply challenges would ease.

CORONAVIRUS IMPACT & CONSUMER CONFIDENCE

The novel coronavirus (COVID-19) continues to have an effect on the U.S. economy since the first case was reported in the United States in January 2020. As of December 31, 2021, 73.7% of the eligible U.S. population have received at least one dose of a COVID-19 Vaccine, while 62.2% are fully vaccinated. Even though vaccination rates are increasing across the country, the new, fast-spreading omicron variant has caused some pessimism amongst analysts about future economic development. Citing omicron and other factors, Oxford Economics downgraded its estimate of U.S. economic growth for the October-December 2021 quarter to a 7.3% annual pace, down from an earlier 7.8% estimate.

The backbone of the U.S. economy is its consumer base. Consumers influence the economic outlook immensely through their spending and savings decisions. As such, measures of consumer confidence and sentiment may provide valuable information in discerning the expected outlook of the economy. In the University of Michigan's *December 2021 Survey of Consumers*, Chief Economist, Richard Curtin opined:

The pandemic recession had an impact on personal finances like no other crisis in more than a half century. While consumers' evaluations of their current and prospective financial situation have both declined, for the first time there has been a substantial gap between the two assessments. The decline in how consumers judged their current financial situation was half as large as the decline in how they judged their future financial prospects. The split is presumably due to the impact of the cash stimulus and unemployment payments.

Future financial evaluations have been lessened primarily by rising inflation as nearly half of all consumers expect falling inflation-adjusted incomes during the year ahead. This divergence provided financial support to the holiday spending spree, but in the months ahead many may turn their focus to changes in wages and prices. The inflationary erosion of living standards are currently reported by one-in-four households, and those inflationary driven cutbacks have continued to spread to middle age, income, and educational groups.

U.S. ECONOMIC OUTLOOOK

FOURTH QUARTER 2021

MONETARY POLICY

The Federal Open Market Committee (FOMC) acts as the monetary policymaking body of the Federal Reserve System. In a statement issued in December 2021, the FOMC noted:

- Indicators of economic activity and employment continue to strengthen, but many sectors remain affected by COVID
- Job gains have been solid, and the unemployment rate has declined substantially
- Supply and demand imbalances continue to contribute to elevated levels of inflation.
- Overall financial conditions remain accommodative, in part reflecting policy measures to support the economy

The report also stated that the path of the economy continues to depend on the course of the virus. In assessing the appropriate stance of monetary policy, the FOMC will keep monitoring the implications of incoming information and will be prepared to make adjustments to maintain smooth market functioning and the flow of credit to households and businesses.

INTEREST RATES

At the end of 2021, the prime interest rate remained at 3.25%. Many banks base prime rates partly on the target level of the federal funds rate as established by the FOMC. In late 2020, the Federal Reserve Board pledged to keep interest rates low until 2023, but, recent forecasts indicate that the end to this accommodative monetary policy may come sooner. The Fed is expected to raise rates above its target rate of 0% to 0.25% next year if inflation continues to surge.

PUBLIC MARKETS

The financial markets finished 2021 with strong, robust returns. On December 31, 2021, the S&P 500 increased 26.9% from December 31, 2020 levels, and was up 10.9% from June 30, 2021. As such, investor attitudes should be optimistic.

FORECAST BASED ON ECONOMIC INDICATORS

In December 2021, members of the Federal Open Market Committee (FOMC) submitted projections of the most likely outcomes for real gross domestic product (GDP) growth, the unemployment rate, and inflation for each year from 2021 to 2024 and over the longer run. These projections were based on information available at the time, assessment of appropriate monetary policy, and assumptions about other factors likely to affect economic outcomes.

- Real GDP growth is expected to slow starting in 2022, and the federal funds rate is expected to increase year-over-year, starting in 2022.
- PCE inflation is expected to decline from 2021 to 2024, while the unemployment rate is expected to decline in 2022, then remain steady through 2024.
- These forecasts suggest that in the long term, the economy will experience a slowing of growth and a decrease in inflation.
- Long-term real GDP growth for the next 10 years is expected to average 1.8%, representing moderate expected real growth.
- Median projections of Federal Reserve data suggest longer-run PCE inflation is expected to be approximately 2.0%, consistent with the FOMC's inflation target.

U.S. ECONOMIC OUTLOOOK

FOURTH QUARTER 2021

CURRENT EMPLOYMENT CONDITIONS – ALL INDUSTRIES

The Bureau of Labor Statistics (BLS) reported that the unemployment rate declined to 3.9% in December 2021, and the number of unemployed persons dropped to 6.3 million. The number of unemployed persons on temporary layoff changed little from the previous month, but ended 2021 down 2.3 million from the previous year.

Notable job gains occurred in food services (+43,000) and leisure and hospitality (+53,000), however, employment in these industries is significantly lower than pre-COVID levels. Employment in professional and business services rose 43,000 in December 2021, nearly matching February 2020 numbers. Employment in construction grew 22,000, and manufacturing added 26,000 jobs in December 2021, but employment remains below figures before the pandemic. There was little or no change in other major industries.

The December 2021 *Beige Book*, reported that employment growth ranged from modest to strong across the 12 Federal Reserve Districts. Contacts noted robust demand for labor but persistent difficulty in hiring and retaining employees. An uptick in employment was noted in leisure, hospitality and manufacturing, but many sectors were still limiting operating hours due to a lack of workers. Childcare issues, retirements, and COVID safety concerns were widely cited as factors limiting labor supply. Employers also noted concerns that the federal vaccination mandate could exacerbate hiring difficulties.

Nearly all Districts reported robust wage growth as hiring struggles and higher turnover rates led businesses to raise wages and offer other incentives, such as bonuses and more flexible working arrangements.

INDUSTRIAL PRODUCTION & MANUFACTURING

The Institute for Supply Management's (ISM) Purchasing Managers Index (PMI) can be used as an indication as to whether or not the manufacturing sector of the economy is expanding or contracting. A PMI of 58.7% in December 2021 noted growth in activity in the manufacturing sector, continuing the trend of monthly expansion in the overall economy. The ISM reports that manufacturing "remains in a demand-driven, supply chain-constrained environment, with indications of improvements in labor resources and supplier delivery performance. Shortages of materials, high commodity prices and difficulties in transporting products continue to plague reliable consumption... However, panel sentiment remains strongly optimistic."

HOUSING & CONSTRUCTION

The Momentum Index, issued by Dodge Data & Analytics is a monthly measure of the initial report for nonresidential building projects in planning, which have been shown to lead construction spending for non-residential buildings by a full year. Though the December report showed slight declines (commercial planning fell 4%, and institutional planning slipped 1%), 2021 was a banner year with the overall Momentum Index increasing 23%, the strongest annual gain since 2005. Increases were noted in both the commercial and institutional components. Despite these positive results, expectations for growth are held in check by continued limitations caused by a tight labor force and the remaining presence of pandemic-related risks.

Meet the Author: Logan Nawrocki, CVA

Logan has nearly three years of professional experience and has earned the CVA credential from NACVA. As a Senior Analyst with GYF's Business Valuation & Litigation Support Services team, Logan performs risk identification, financial statement analysis, industry and economic research, and financial modeling. He also assists in valuing privately held companies for various purposes.