

2021

4th QUARTER

ECONOMIC OUTLOOK

United States Economy :

Current Economic Conditions and Recent Developments

Federal Reserve – 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:¹

Overall Economic Activity

- Economic activity grew at a modest to moderate pace in most Federal Reserve Districts during October and early November 2021.
- Several Districts noted that despite strong demand, growth was constrained by supply chain disruptions and labor shortages.
- Consumer spending increased modestly; low inventories held back sales of some items, notably light vehicles.
- Leisure and hospitality activity picked up in most Districts as the spread of the Delta variant ebbed in many areas.
- Construction activity generally increased but was held back by scarce materials and labor.
- Nonresidential real estate activity increased widely, while residential real estate activity grew in some Districts but declined in others.
- Manufacturing growth was solid across Districts, though materials and labor shortages limited expansion.
- High freight volumes continued to strain distribution systems.
- Energy activity was generally higher, growth in professional and business services varied widely, and demand for education and health services was largely unchanged.
- Loan demand increased in almost all Districts, though some reported declines in residential mortgages.
- Agriculture saw improved financial conditions overall and rising land values.
- The outlook for overall activity remained positive in most Districts, but some noted uncertainty about when supply chain and labor supply challenges would ease.

Employment and Wages

In terms of Employment and Wages, the most recent *Beige Book* reported modest to strong growth:²

“Employment growth ranged from modest to strong across Federal Reserve Districts. Contacts reported robust demand for labor but persistent difficulty in hiring and retaining employees. Leisure and hospitality and manufacturing contacts reported an uptick in employment, but many were still limiting operating hours due to a lack of workers. Contacts in several other sectors also noted labor-related constraints on meeting demand. Childcare, retirements, and COVID safety concerns were widely cited as sources that limited labor supply. Many Districts noted concerns that the federal vaccination mandate could exacerbate existing hiring difficulties. Nearly all Districts reported robust wage growth. Hiring struggles and elevated turnover rates led businesses to raise wages and offer other incentives, such as bonuses and more flexible working arrangements.”

¹ [Beige Book – December 1, 2021.](#)

² Ibid.

Federal Open Market Committee – Monetary Policy Commentary

The Federal Open Market Committee (“FOMC” or the “Committee”) acts as the monetary policymaking body of the Federal Reserve System. The FOMC makes all decisions regarding open market operations, which affect the federal funds rate (rate at which depository institutions lend to each other), the size of the Federal Reserve’s asset holdings, and public communication regarding the likely course of future monetary policy.³ Information contained in the [statement issued on December 15, 2021](#), indicates that:⁴

- Indicators of economic activity and employment have continued to strengthen, but many sectors continue to be affected by COVID-19.
- Job gains have been solid, and the unemployment rate has declined substantially.
- Supply and demand imbalances have continued to contribute to elevated levels of inflation.
- Overall financial conditions remain accommodative, in part reflecting policy measures to support the economy and the flow of credit to U.S. households and businesses.

Overall, the FOMC notes that the path of the economy continues to depend on the course of the virus. Progress on vaccinations and an easing of supply constraints are expected to support continued gains in economic activity and employment as well as a reduction in inflation. Risks to the economic outlook remain, including from new variants of the virus.

The FOMC reported that it seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. In support of these goals, the Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent.

“With inflation having exceeded 2 percent for some time, the Committee expects it will be appropriate to maintain this target range until labor market conditions have reached levels consistent with the Committee’s assessments of maximum employment. In light of inflation developments and the further improvement in the labor market, the Committee decided to reduce the monthly pace of its net asset purchases by \$20 billion for Treasury securities and \$10 billion for agency mortgage-backed securities. Beginning in January, the Committee will increase its holdings of Treasury securities by at least \$40 billion per month and of agency mortgage-backed securities by at least \$20 billion per month. The Committee judges that similar reductions in the pace of net asset purchases will likely be appropriate each month, but it is prepared to adjust the pace of purchases if warranted by changes in the economic outlook.

The Federal Reserve’s ongoing purchases and holdings of securities will continue to foster smooth market functioning and accommodative financial conditions, thereby supporting the flow of credit to households and businesses. In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee’s goals. The Committee’s assessments will take into account a wide range of information, including readings on public health, labor market conditions, inflation pressures and inflation expectations, and financial and international developments.”⁵

³ [Structure of the Federal Reserve System, Federal Open Market Committee.](#)

⁴ [Federal Reserve issues FOMC statement, December 15, 2021](#)

⁵ Ibid.

Coronavirus Impact

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 population of Americans have received at least one dose of a COVID-19 Vaccine, while 62.2% of eligible Americans are fully vaccinated.⁶

However, even though vaccination rates are increasing across the country, the new, fast-spreading omicron variant has caused some pessimism amongst analyst about future economic development. In fact, "Citing omicron and other factors, Oxford Economics has downgraded its estimate of U.S. economic growth for the October-December quarter to a 7.3 percent annual pace, down from an earlier 7.8 percent estimate."⁷

Current Employment Conditions

The Bureau of Labor Statistics (BLS) reported that the unemployment rate declined to 3.9% in December 2021.⁸ Total nonfarm payroll employment rose by 199,000 in December 2021 from the previous month. Notable job gains occurred in leisure and hospitality, professional and business services, manufacturing, and transportation and warehousing.⁹

In December 2021, the unemployment rate and the number of unemployed persons, at 3.9% and 6.3 million, respectively, both dropped from the previous month. The number of unemployed persons who were on temporary layoff changed little from the previous month, but ended 2021 down 2.3 million from the previous year. The persons not in the labor force who currently want a job changed little from the previous month, but saw an increase of 717,000 from the beginning of the pandemic in February 2020. The number of persons who reported that they had been unable to work because their employers closed or lost business due to the pandemic (that is, they did not work at all or worked fewer hours at some point in the last 4 weeks due to Covid) fell to 3.1 million, down from 3.6 million in the previous month.¹⁰

The BLS also noted:¹¹

- Employment in leisure and hospitality continued to trend up in December (+53,000) 2021. Leisure and hospitality has added 2.6 million jobs in 2021, but employment in the industry is down by 1.2 million, or 7.2 percent, since February 2020. Employment in food services and drinking places rose by 43,000 in December 2021, but is down by 653,000 since February 2020.
- Employment in professional and business services continued its upward trend (+43,000) in December 2021. Over the month, job gains occurred in computer systems design and related services (+10,000), in architectural and engineering services (+9,000), and in scientific research and development services (+6,000). Employment in professional and business services overall is slightly below (-35,000) its level in February 2020.
- Manufacturing added 26,000 jobs in December 2021, primarily in durable goods industries. A job gain in machinery (+8,000) reflected the return of workers from a strike. Manufacturing employment is down by 219,000 since February 2020.
- Construction employment rose by 22,000 in December 2021, following monthly gains averaging 38,000 over the prior 3 months. In December, job gains occurred in nonresidential specialty trade

⁶ [Coronavirus \(COVID-19\) Vaccinations.](#)

⁷ [Omicron casts shadow over Economy's pandemic recovery.](#)

⁸ [The Employment Situation – December 2021 – Bureau of Labor Statistics.](#)

⁹ Ibid.

¹⁰ Ibid.

¹¹ Ibid.

contractors (+13,000) and in heavy and civil engineering construction (+10,000). Construction employment is 88,000 below its February 2020 level.

- In December 2021, employment showed little or no change in other major industries, including retail trade, information, financial activities, health care, other services, and government.

The following table contains historical U.S. unemployment rates. The unemployment rate from March 2018 to February 2020 was between 3.5% and 4.0%, indicating the economy was at or near full employment. The rising unemployment rate starting in March 2020 is due to the coronavirus and its effects.

UNITED STATES UNEMPLOYMENT RATE												
	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>	<u>May</u>	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>	<u>Nov</u>	<u>Dec</u>
2017	4.8%	4.7%	4.5%	4.4%	4.3%	4.3%	4.3%	4.4%	4.2%	4.1%	4.1%	4.1%
2018	4.1%	4.1%	4.0%	3.9%	3.8%	4.0%	3.9%	3.8%	3.7%	3.8%	3.7%	3.9%
2019	4.0%	3.8%	3.8%	3.6%	3.6%	3.7%	3.7%	3.7%	3.5%	3.6%	3.5%	3.5%
2020	3.6%	3.5%	4.4%	14.7%	13.3%	11.1%	10.2%	8.4%	7.8%	6.9%	6.7%	6.7%
2021	6.3%	6.2%	6.0%	6.1%	5.8%	5.9%	5.4%	5.2%	4.7%	4.6%	4.2%	3.9%

Source: YCharts.com

Economic Forecast – Major Indicators

Gross Domestic Product (GDP) and Inflation

In conjunction with the Federal Open Market Committee (FOMC) meeting held on December 14-15, 2021, meeting participants submitted their 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. Each participant's projections were based on information available at the time of the meeting, together with her or his assessment of appropriate monetary policy – including a path for the federal funds rate and its longer-run value – and assumptions about other factors likely to affect economic outcomes.

The longer-run projections represent each participant's assessment of the value to which each variable would be expected to converge, over time, under appropriate monetary policy and in the absence of further shocks to the economy. "Appropriate monetary policy" is defined as the future path of policy that each participant deems most likely to foster outcomes for economic activity and inflation that best satisfy his or her individual interpretation of the statutory mandate to promote maximum employment and price stability.¹²

The following table contains the median forecasts of the participating individuals.

FEDERAL RESERVE ECONOMIC PROJECTIONS (MEDIAN)					
	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>Longer Run</u>
Change in Real GDP	5.5%	4.0%	2.2%	2.0%	1.8%
Unemployment Rate	4.3%	3.5%	3.5%	3.5%	4.0%
PCE Inflation	5.3%	2.6%	2.3%	2.1%	2.0%
Federal Funds	0.1%	0.9%	1.6%	2.1%	2.5%

Source: Federal Open Market Committee, December 14-15, 2021

¹² [Summary of Economic Projections. Federal Open Market Committee. December 2021.](#)

Real GDP growth is expected to slow 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, and the federal funds rate is expected to increase year-over-year, starting in 2022. 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. The 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.

Industrial Production and 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 above 50.0 indicates that the manufacturing economy is generally expanding, while a reading below 50.0 indicates that it is generally contracting.¹³ In December 2021, the PMI decreased 2.4 points from the 61.1 percent reading in November 2021.¹⁴ This continues the trend of monthly expansion in the overall economy for the 19th month in a row after a contraction in April 2020.¹⁵

Timothy R. Fiore, Chair of the Institute for Supply Management, noted:

“The U.S. manufacturing sector remains in a demand-driven, supply chain-constrained environment, with indications of improvements in labor resources and supplier delivery performance. Shortages of critical lowest-tier materials, high commodity prices and difficulties in transporting products continue to plague reliable consumption. Coronavirus pandemic-related global issues – worker absenteeism, short-term shutdowns due to parts shortages, employee turnover and overseas supply chain problems – continue to impact manufacturing. However, panel sentiment remains strongly optimistic, with six positive growth comments for every cautious comment, down slightly from November.”¹⁶

Consumer Confidence

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. The University of Michigan’s December 2021 Preliminary Data *Surveys of Consumers* reported the following:¹⁷

UNIVERSITY OF MICHIGAN SURVEYS OF CONSUMERS					
	<u>Dec-21</u>	<u>Nov-21</u>	<u>Dec-20</u>	<u>M-M Change</u>	<u>Y-Y Change</u>
Index of Consumer Sentiment	70.4	67.4	80.7	4.5%	-12.8%
Current Economic Conditions Index	74.6	73.6	90.0	1.4%	-17.1%
Index of Consumer Expectations	67.8	63.5	74.6	6.8%	-9.1%
<i>Source: University of Michigan, Surveys of Consumers, Preliminary Results for January 2022</i>					

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

¹³ [December 2021 Manufacturing ISM Report on Business.](#)
¹⁴ Ibid.
¹⁵ Ibid.
¹⁶ Ibid.
¹⁷ [Surveys of Consumers. University of Michigan. December 2021.](#)

how consumers have judged their current financial situation was half as large as the decline in how they judged their future financial prospects (see the chart). 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, middle income, and middle educational groups.”¹⁸

Housing and Construction

The Momentum Index, issued by Dodge Data & Analytics (“Dodge”) is a monthly measure of the initial report for nonresidential building projects in planning, which have been shown to lead construction spending for nonresidential 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 for the Dodge Momentum Index. Throughout the year, the overall Momentum Index increased 23%, the strongest annual gain since 2005. Gains were noted in both the commercial and institutional components of the Momentum Index, which reached 13- and 14-year highs, respectively.¹⁹

According to the report, 21 commercial and institutional projects with a value of \$100 million or more entered planning in December 2021. The Dodge Momentum Index seems to indicate that this construction activity will continue to improve in 2022. However, optimism for growth is held in check by the continued limitations caused by the remaining presence of pandemic-related risks and a tight labor force.²⁰

Interest Rates

As of December 31, 2021, the prime interest rate remained at 3.25%.²¹ The prime rate is posted by a majority of the top 25 (by assets in domestic offices) insured U.S. chartered commercial banks and is one of the several base rates used by banks to price short-term business loans. While the Federal Reserve does not control the prime rate, many banks base their prime rates partly on the target level of the federal funds rate (the rate that banks charge each other for short-term loans) as established by the FOMC.²²

Although, the Federal Reserve Board promised to keep interest rates low until 2023, recent forecasts indicate that the end to this accommodative monetary policy could come sooner than the Fed originally pledged in September 2020, as the Fed “is expected to raise rates above its target rate of 0% to 0.25% next year if the economic recovery continues.”²³

In public markets, asset prices continually fluctuate with changes in future expectations. Thus, the impact on publicly traded equity valuations is focused not necessarily on the trend of lower future interest rates, but rather, whether or not the current expectations are higher or lower than previous estimates. The anticipated impact of interest rate projections on the expected overall cost of capital and equity valuations cannot be readily discerned, as other variables necessary to make such a generalization are unknown.

¹⁸ Ibid.

¹⁹ [Dodge Momentum Index Declines in December](#)

²⁰ Ibid.

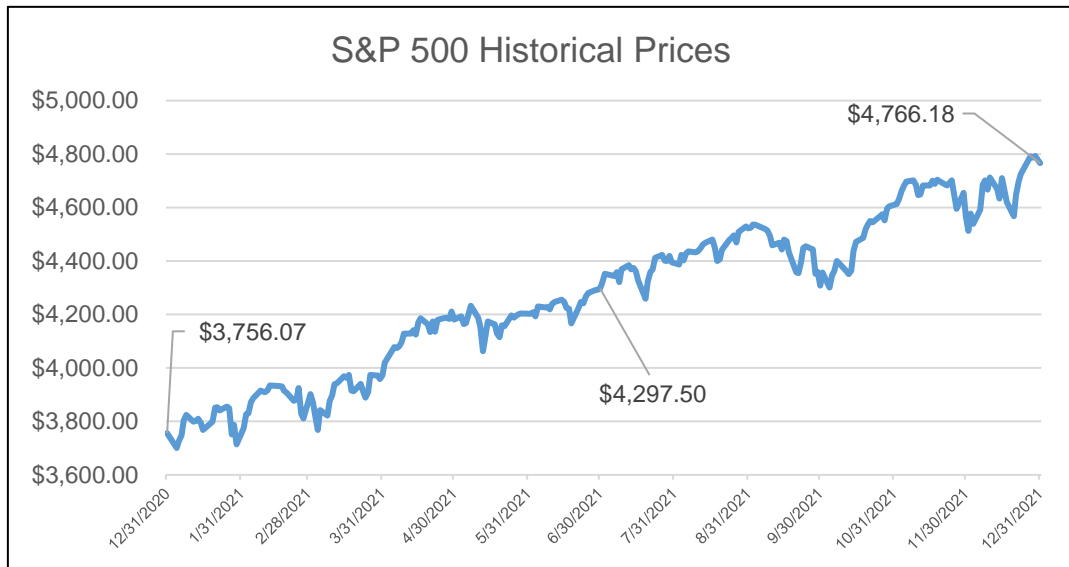
²¹ [Board of Governors of the Federal Reserve System, Select Interest Rates, Bank Prime Loan.](#)

²² [“What is the prime rate and does the Federal Reserve set the prime rate?”](#)

²³ [Fed prepared to raise interest rates if inflation continues to surge.](#)

However, in analyzing changes in the expected level of the S&P 500 Index, we are able to discern if economic conditions have evolved in a way that would generally suggest higher or lower equity values.

As shown below, on December 31, 2021, the S&P 500 had increased 26.9% from December 31, 2020 levels, and was up 10.9% from June 30, 2021.²⁴ As such, investor attitudes should be optimistic.



Economic Outlook Conclusion

The financial markets finished 2021 with strong, robust returns. However, in the first month of the new year a shift in investor sentiment fueled by language from the Federal Reserve on the timing of interest rate hikes prompted a swift flight to quality and an outflow of capital from equities to cash and bonds. Multiples have compressed with growth rates returning to pre-Covid levels, indicating investors are no longer rewarding riskier investments. Inflation continues to be a major theme driving the market with energy and commodities benefiting. Bond yields have flattened with the two-year and ten-year converging. If the Federal Reserve doesn't hit the mark just right, the yield curve is in danger of inverting. Both consumer demand and demand for new construction were left unmet due to labor shortages and supply chain delays.

An increase in positive coronavirus cases attributable to the omicron variant has slowed the economy's return to "normal", as many Americans are still hesitant to return to pre-pandemic activities. Continued themes are supply chain disruptions that may not normalize until well into 2023 and unemployment rates returning to the natural rate with prolonged labor shortages in certain sectors. Thus, after considering all factors, the economy at the end of 2021 is continuing to expand, but expansion may be short-lived.

²⁴ [S&P 500 \(^SPX\). YCharts.com](https://ycharts.com/indicators/%5E%5BSPX%5D)