U.S. ECONOMIC OUTLOOOK

SECOND QUARTER 2021

CURRENT ECONOMIC CONDITIONS COMMENTARY

The overall current U.S. economic outlook is positive as the nation begins to move out of the pandemic. Due to increasing vaccinations and the associated relaxations of COVID-related restrictions, businesses across the country have begun to open back up to full capacity, which has provided a much-needed boost to the economy. The markets responded well in the second quarter of 2021, and economic indicators have shown an improvement in most sectors. However, experts and consumers remain cautious, recognizing that the path of the economy will depend significantly on the course of the virus, and risks to the economic outlook remain for the rest of 2021.

The Federal Reserve *Beige Book* is a report published eight times a year to summarize current economic conditions throughout the 12 U.S. Federal Reserve Districts. The *Beige Book* released on June 2, 2021, noted that the economy expanded at a moderate pace from early April to late May 2021, a somewhat faster rate than the prior reporting period. Several Districts cited positive economic effects that were most notable in consumer spending, in which increases in leisure travel and restaurant spending augmented ongoing strength in other categories. However, many industries noted the adverse impacts of supply chain disruptions, especially in manufacturing, distribution and construction. Despite a moderate increase in staffing levels, labor demand remained strong. Overall, expectations changed little, with contacts in the Districts optimistic that economic growth will remain solid.

CORONAVIRUS IMPACT

As of June 30, 2021, 47% of the U.S. population is fully vaccinated, and 55% of those eligible have received at least one dose of a vaccine. Experts project that 70-85% of the population must be vaccinated in order to turn the page on COVID-19. Despite falling short of this vaccination target, increases in consumer spending indicate a strong desire to return to a sense of normalcy by visiting restaurants, attending events, and taking vacations.

While most consumers are optimistic about a gradual end to the COVID pandemic, many still worry about risks from emerging variants. It is unlikely that they will reduce their savings and wealth to pre-pandemic levels, but rather, will maintain a higher level of precautionary funds.

Bolstered by governmental support programs (i.e., stimulus payments and child tax credits), consumers continue to make purchases, but spending remains below pre-pandemic levels.

CONSUMER CONFIDENCE

Consumers influence the U.S. economic outlook immensely through their spending and saving decisions. According to the University of Michigan's *Surveys of Consumers*, consumer confidence continued to rise in the second quarter of 2021. Although sentiment slipped a bit in late June, it remained 3.1% above the May 2021 reading, and was at the second highest rating since the start of the pandemic.

The June 2021 *Survey* included several key points with respect to three critical economic factors that are watched closely by consumers – inflation, unemployment and interest rates:

- In June 2021, year-ahead inflation expectations fell slightly to 4.2% from the decade-high peak of 4.6% in May 2021. Consumers believed that price surges will mostly be temporary.
- 56% of the respondents expected declines in unemployment in the year ahead, which was the highest proportion recorded in the history of the surveys.
- Nearly 75% of consumers predicted rising interest rates during the year ahead, marking the highest proportion recorded since 2018, when the economy was near its peak.

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MONETARY POLICY & INFLATION

The Federal Open Market Committee (FOMC) acts as the monetary policymaking body of the Federal Reserve System. In June 2021, the FOMC released observations that will likely impact future monetary policy. Indicators of economic activity and employment have strengthened in the second quarter. Financial conditions remain accommodative, reflecting government measures to support the economy and the flow of credit to U.S. households and businesses.

INFLATION & INTEREST RATES

Inflation has risen, largely reflecting transitory factors, but, the threat of lasting inflation has been priced out with the 10-year yield falling below pre-pandemic levels. In September 2020, the Federal Reserve pledged to keep interest rates near zero until 2023. As of June 30, 2021, the prime interest rate, which is one of several base rates used by banks to price short-term business loans, remains at 3.25%.

PUBLIC MARKETS

Asset prices in public markets fluctuate with changes in future expectations. So far, in 2021, the market has responded positively to earnings and a huge amount of Fed intervention that is not tapering. In the first half of 2021, the three major U.S. stock indexes performed extremely well:

- The S&P 500 was up 2.0% in June, and closed the first half of 2021 up 14.4%.
- The NASDAQ also saw increases, climbing 5.0% in June 2021, and 12.5% for the year.
- The DJIA remained steady in the month of June, and was up 12.7% for 2021.

Analysts expect to see a rotation from high-beta to value stocks. Low interest rates continue to drive corporate borrowing. Corporations use this capital to buy back their stock, generally creating higher stock prices. For details on specific trends in stocks and indices, read GYF's 2Q 2021 Public Market Report.

FORECAST BASED ON ECONOMIC INDICATORS

The Bureau of Economic Analysis (BEA) 2Q 2021 Advance Estimate reports that real GDP increased at an annual rate of 6.5% in the second quarter of 2021 (compared to 6.3% in 1Q 2021). The increase reflects rising personal consumption expenditures, nonresidential fixed investment, exports, and state and local government spending due to the continued economic recovery and government response related to the COVID-19 pandemic.

On June 16, 2021, the Federal Reserve released forecasts for several economic indicators, which suggest that in the long term, the economy will experience a slowing of growth and decreasing inflation.

- Real GDP growth is expected to slow throughout 2021. Long-term real GDP growth for the next 10 years is expected to average 1.8%, representing moderate expected real growth.
- A decline in personal consumption expenditures (PCE) inflation is anticipated from 2021 to 2023. Median projections of Federal Reserve data suggest that long-run PCE inflation is expected to be approximately 2.0%.
- The unemployment rate is expected to drop year-over-year to 2023.
- The federal funds rate is projected to remain constant until 2023.

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CURRENT EMPLOYMENT CONDITIONS – ALL INDUSTRIES

The Bureau of Labor Statistics (BLS) reported that the unemployment rate remained fairly steady in June 2021. The number of unemployed persons on temporary layoff and those who were jobless <5 weeks changed little, staying at 1.8 million and 2.0 million, respectively. As consumers began to return to social activities, employment growth was strongest in hospitality, food services, and retail. Industry data shows modest job increases in most sectors, but overall employment has not returned to pre-COVID levels.

The *Beige Book*, which reported increased hiring across industries, noted that it remains difficult to find new employees, especially low-wage hourly workers, truck drivers, and skilled tradespeople. The lack of job candidates prevented some companies from increasing their output and led others to reduce operating hours. Overall, wage growth was moderate. Many businesses offered signing bonuses and increased starting salaries to attract and retain workers. Labor demand is expected to remain strong, and supply will continue to be constrained, in coming months.

CRYPTOCURRENCY

After getting a hot start in the first half of 2021, cryptocurrency began to cool off in the second quarter. The world's largest crypto, bitcoin, plummeted below $32,000 per coin at the end of June 2021, down from $63,000+ per coin in April 2021.

Larger, well-known companies (including Square and Tesla) that opted to invest in the coin felt the impact of the recent drop, recording large bitcoin-related impairments in 2Q 2021.

INDUSTRIAL PRODUCTION & MANUFACTURING

The Institute for Supply Management reports a monthly Purchasing Managers Index (PMI), which can be used to determine whether the manufacturing sector is expanding or contracting. The PMI decreased 0.6 points to 60.6 in June, compared to May 2021. This figure indicates expansion in the overall economy for 13 consecutive months, after a contraction in April of 2020.

Manufacturers and suppliers continue to struggle to meet increasing levels of demand due to shortages of materials and labor. These challenges will likely accelerate the move to use more automation in the production process.

COMMERCIAL & RESIDENTIAL CONSTRUCTION

The Dodge Data & Analytics Momentum Index is a monthly measure of the first (or initial) report for nonresidential building projects in planning, an indicator that has been shown to lead construction spending for nonresidential buildings by a full year. In June 2021, the Momentum Index fell 5% from 175.1 in May 2021, due to losses in both institutional and commercial planning. However, the Index remains near a 13-year high, well above last year.

As inflation rates continue to rise due to the pandemic, the construction sector will likely see a price hike in raw materials, which is predicted to lead to a slowdown in new construction projects in the back half of 2021.

Meet the Author: Logan Nawrocki, CVA

Logan is a Valuation Analyst in GYF's Business Valuation & Litigation Support Services Group and has earned the CVA credential from NACVA. He performs risk identification, financial statement analysis, industry and economic research, and financial modeling. Logan assists in valuing privately-held companies for a variety of purposes.