U.S. ECONOMIC OUTLOOOK

THIRD QUARTER 2021

CURRENT ECONOMIC CONDITIONS COMMENTARY

The U.S. economy continued its recovery in the third quarter of 2021, however, as we move into the fourth quarter, rising COVID infection rates could slow economic expansion. Consumer spending in Q3 2021 remained stagnant as rising inflation rates offset consumers with disposable income looking to spend. Most sectors saw job increases in the quarter, a positive sign for the economy overall, but employee shortages and supply chain issues have hindered employers ability to meet demand in many industries. The current economic outlook is positive but cautious.

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 September 8, 2021, noted that the rate of economic growth slowed slightly in the third quarter of 2021. The deceleration was largely attributable to a decrease in dining out, travel and tourism due to the rise in the Delta variant of COVID-19. Other sectors with slower growth were those constrained by supply disruptions and labor shortages rather than lack of demand, such as auto sales. The strongest sectors in Q3 2021 were manufacturing, transportation, nonfinancial services and residential real estate, though growth in home sales and manufacturing were hindered by lack of inventory. Businesses in most Districts surveyed remained optimistic, however, widespread concern remains regarding availability of resources.

CORONAVIRUS IMPACT

At the end of September 2021, 215 million Americans (65.3% of the eligible population) had at least one dose of a COVID-19 vaccine, and 186 million (56.3% of those eligible) were fully vaccinated. In an effort to further reduce the spread of COVID, on September 22, 2021, the USFDA approved the use of a single-dose booster vaccine for those determined to be at higher risk of infection.

These efforts work to help keep the economy open, but the vaccinations may be offering a false sense of security. It is likely that COVID-19 will continue to have a negative impact for the rest of 2021. The spread of the Delta variant during the summer created a feeling of panic for Americans, but the country has yet to realize the full impact of the virus as we head into the winter months and more people will spend time together indoors and will likely visit family and friends over the holidays.

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 in the third quarter of 2021 declined, remaining at the lows first recorded in response to the shutdown of the economy in 2020. Contributing factors to the negative outlook include the spread of COVID-19 due to the Delta variant, supply chain disruptions, and labor shortages. The report also noted that confidence in government economic policies has significantly declined during the past six months.

The *September 2021 Survey* included several key points with respect to factors impacting consumer confidence:

- The expected year-ahead inflation rate was 4.6% in September 2021, unchanged from August 2021, and well above the 2.6% from September 2020.
- 30% of households polled in September expected to be better off financially in a year, the lowest level since August 2016.
- Real income gains were expected by just 18% of all households in September, the lowest reading since February 2015.

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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 September 2021, the FOMC released observations that will likely impact future monetary policy. The report notes that indicators of economic activity and employment continued to strengthen over the Q3 2021, and overall financial conditions remain accommodative. However, the path of the economy continues to depend on the course of the COVID virus.

INFLATION & INTEREST RATES

The FOMC attributed elevated inflation primarily to transitory factors. The Federal Reserve pledged to keep interest rates low until 2023, but recent forecasts indicate that the end to this policy could come sooner. The central bank noted, “If progress continues broadly as expected, …moderation in the pace of asset purchases may soon be warranted.”

PUBLIC MARKETS

Asset prices in the public markets fluctuate with changes in future expectations. The growth rate has slowed some the third quarter of 2021, however, overall market performance continues to be positive due, in large part, to the accommodative monetary policy in place since the pandemic began.

Significant year-to-date increases were noted in most major stock indices. On September 30, 2021, the S&P 500 was up 28.1% from September 2020. For details on specific trends in stocks and indices, read GYF's Q3 2021 Public Market Report.

Signs of continued economic recovery were reflected in record-setting M&A transaction activity, which was illustrated in both deal value and volume. This pace is expected to remain strong for the rest of the year, despite rising COVID infection rates that could slow overall economic growth.

FORECAST BASED ON ECONOMIC INDICATORS

The Bureau of Economic Analysis (BEA) reports that real gross domestic product (GDP) increased at an annual rate of 2.1% percent in Q3 2021 (compared to 6.7% in Q2 2021). The Q3 growth reflected increases in private inventory investment, PCE, state and local government spending, and nonresidential fixed investment that were partly offset by decreases in residential fixed investment, federal government spending, and exports.

In September, 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 decrease in inflation.

- Real GDP growth is expected to slow starting in 2022. 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 2024. Median projections of Federal Reserve data suggest that longer-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 increase year-over-year, starting in 2022.

CURRENT EMPLOYMENT CONDITIONS – ALL INDUSTRIES

The Bureau of Labor Statistics (BLS) reported that the unemployment rate fell by 0.4% to 4.8% in September 2021. Notable job gains occurred in leisure and hospitality, professional and business services, retail trade, and transportation and warehousing. The number of unemployed persons also dropped to 7.7 million from the prior month, but unemployed persons on temporary layoff (1.1 million) and unemployed persons jobless less than 5 weeks (2.2 million) changed little from the previous month. The number of persons unable to work because employers closed or lost business due to the pandemic fell to 5.0 million.

According to the September *Beige Book*, which reported that economic growth downshifted slightly in the third quarter of 2021 to a moderate pace, hiring continues to be a challenge across all industries. Demand for workers continued to strengthen, but extensive labor shortages were constraining employment and impeding business in many cases. The report characterized wage growth as strong with particularly brisk wage gains among lower-earners. Employers reported using more frequent raises, bonuses, training, and flexible work arrangements to attract and retain workers

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 increased 1.2 points, to 61.1, in September 2021, compared to August 2021, indicating continued expansion in the overall economy.

The ISM reported that companies and suppliers continue to deal with an unprecedented number of hurdles to meet increasing demand. All segments of the manufacturing economy are still being negatively impacted by record-long raw materials lead times, critical material shortages, high commodities prices and transportation difficulties. Though challenges related to finding and keeping qualified workers, shutdowns due to lack of parts, and supply chain problems continue to limit growth potential, the industry outlook remains positive. Uncertainty looms as we move into the final quarter of 2021.

COMMERCIAL & RESIDENTIAL CONSTRUCTION

The Momentum Index, published monthly by Dodge Data & Analytics is a 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 year. The September 2021 Index reported an 11% gain compared to August 2021. The report noted a 13% increase in the commercial planning component and an 8% rise in institutional planning. 17 projects with a value of $100 million or more entered planning during September 2021.

This gain in the Momentum Index and its components is certainly a positive sign that developers and owners are looking past the current concerns over pricing, Delta, and politics, and are moving forward with projects to meet demand. However, this optimism does not mean smooth sailing ahead for the sector. Month-to-month volatility in the data is likely to remain for some time.

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.