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Q3 2021 ECONOMIC REPORTS

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GDP GROWTH | EMPLOYMENT | MONETARY POLICY | GLOBAL ECONOMY

GDP GROWTH: TRENDING IN Q3 2021

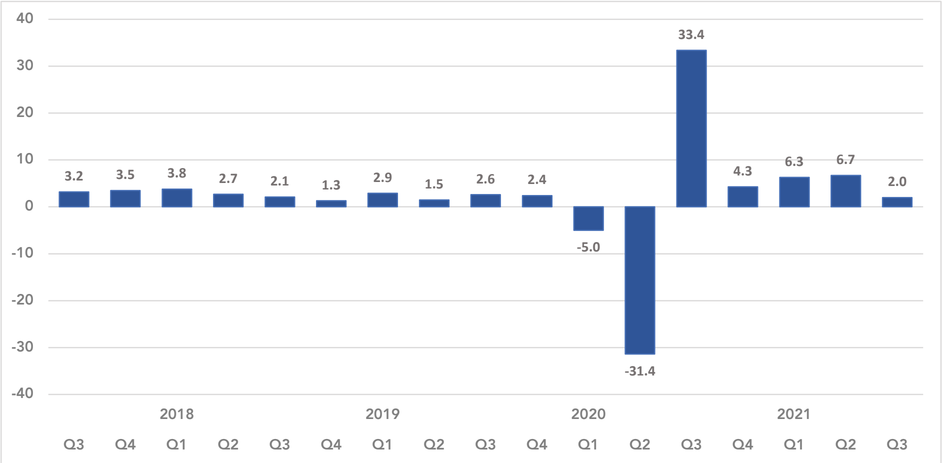
The U.S. economy slowed in the third quarter as growth was tripped up by spiking Covid Delta infections, supply-chain bottlenecks and ebbing fiscal stimulus. Annualized gross domestic product rose 2% in the third quarter, down sharply from 6.7% in the second quarter, according to the Commerce Department.

Economists generally believe the slowdown will be temporary if virus infections continue to fall. This will enable greater socialization and a resumption of spending in restaurants and on travel – sectors that were hit hard in the last three months.

"We had a temporary set of impediments coming from a resurgence of the coronavirus that should ease as we move through the quarters ahead," Northern Trust economist Carl Tannenbaum told the Wall Street Journal. "It's a speed bump not a slowdown," Constance Hunter, KPMG's chief economist, told the New York Times. But there are concerns that disruptions in global logistics – such as the record levels of imports that are overwhelming U.S. port and trucking capacities – will take longer to sort out. The delays are costly. A fall-off in the production of cars and trucks, caused by computer chip shortages, hobbled booming auto sales and reduced the Q3 GDP about 2.4%. "The economy doesn't have a demand problem. It has a supply problem," IHS Markit CEO Ben Herzon told the Washington Post.

Real GDP: Percent Change from Prior Quarter

U.S. Bureau of Economic Analysis - Seasonally adjusted at annual rates



'The economy doesn't have a demand problem. It has a supply problem' – IHS Markit, CEO Ben Herzon.

Spending on services grew at a 7.9% annual rate in the third quarter, but consumer spending rose at an annual rate of 1.6%, a steep reduction from the 12% increase in Q2. There was a jump in private inventory investment that reflected increases in wholesale and retail trade.

It was widely hoped that vaccines would bolster the economy in the second half, but the Delta variant took hold at the start of the third quarter, spoiling those expectations. Nevertheless, the economy has passed its pre-pandemic peak. After adjusting for inflation, nearly 6% growth for the year still is expected.

In addition to the drop in car sales, there was a drop in residential investment, which includes new home construction and renovation, which trimmed 0.4 percentage points off GDP, due to shortages in construction materials and appliances.

"It is frustrating to acknowledge that getting people vaccinated and getting Delta under control still remains the most important economic policy that we have," Fed Chair Jerome Powell said in late September. "And it's frustrating to see the bottlenecks and supply chain problems getting a little bit worse."

Current-dollar GDP increased in Q3 at $432.5 billion, for an annual rate of 7.8% to a level of $23.17 trillion. In the second quarter, GDP was up 13.4% or $702.8 billion. The price index for gross domestic purchases increased 5.4% in Q3, compared with 5.8% in Q2. The Personal Consumption Expenditures index increased 5.3% in Q3 compared to 6.5% in Q2.

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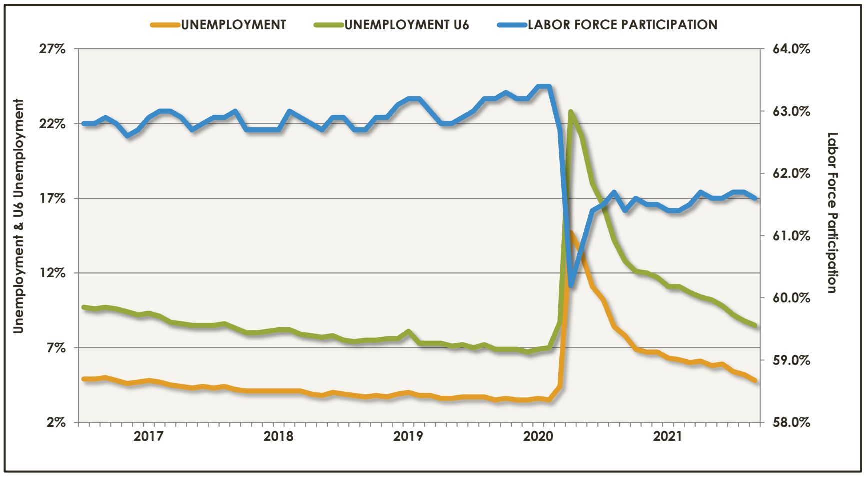
EMPLOYMENT: TRENDING IN Q3 2021

Nonfarm payroll employment increased by 194,000 in September, a drop from the 561,000 monthly average this year. Nevertheless, the unemployment rate fell by 0.4% percentage point to 4.8%. The biggest job gains were in leisure and hospitality, professional and business services, retail trade, transportation and warehousing.

In September there were 5 million people reporting their employer had closed or lost business due to the pandemic. The Labor Department also reported that the number of marginally attached workers increased by 167,000 and discouraged workers were up by 58,000. Despite nationwide vaccine distribution that is reviving the economy, many workers laid off during the pandemic lately are slow to return to the labor force. This is despite more than 10 million job openings. By some estimates, about 4.3 million persons have checked out of the workforce.

Workers are quitting at or near the highest rates on record. The decline in participation is occurring across demographic groups and particularly among women, workers without college degrees and low-paying jobs like childcare and hospitality. There are concerns among economists over whether the deviation from typical employment patterns will subside or whether Covid has forced structural cracks in relationships between worker and employer as well as between jobs and employment. There had been expectations that school re-openings, expiring unemployment benefits and the fading Delta variant would bring back workers this fall. But it appears that labor shortages may be deepening. Of 52 economists interviewed by The Wall Street Journal, 22 said participation would never return to its pre-pandemic level.

United States Unemployment



'We don't know how to reignite this thing right now" – Economist Ron Hetrick, Emsi Burning Glass.

"Our problem is not an economy that doesn't want to get started – it's already started. It just doesn't have people to make the engine run. We don't know how to reignite this thing right now," said economist Ron Hetrick of Emsi Burning Glass. The near-term prospect of a reduced labor force could make it difficult for large employers to meet hiring goals for the holiday season. Walmart and Amazon say they aim to hire more than 300,000 workers in the coming months. UPS and FedEx say they hope to hire nearly 200,000 mostly package handlers.

The WSJ says there are "myriad" reasons for the labor shortages and sometimes they're interrelated: Total daycare workers were down 108,7000, or 10.4%, in September compared to February 2020, Labor Department data show, despite a 10% increase in wages. Consequently, more costly, hard-to-find daycare prompts some parents to stay home rather than return to work. Many baby boomers, fearful of the virus and their portfolios swelled by the bull market, are taking early retirement. Others are opting for self-employment and, of course, trillions in government relief have made many less keen to return to unfulfilling jobs.

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MONETARY POLICY: TRENDING IN Q3 2021

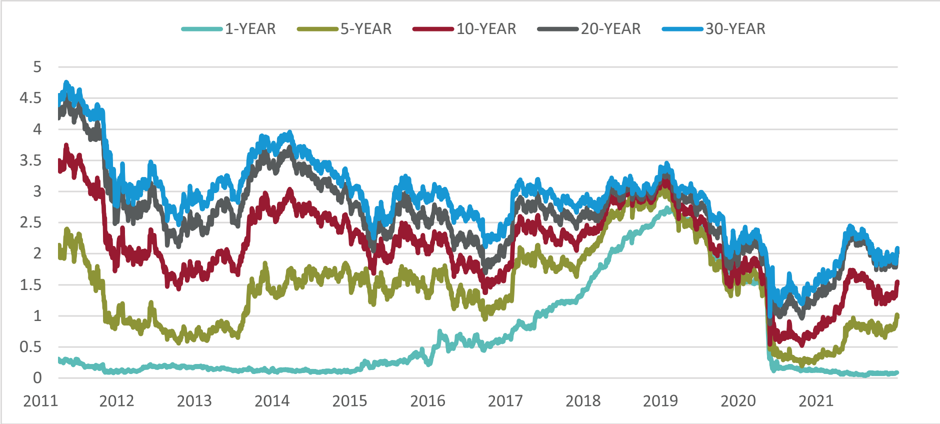
Mounting inflationary pressures have moved the Federal Reserve to announce plans to scale down its asset purchase program beginning late this year. The central bank also signaled that it could raise interest rates six or seven times by the end of 2024. Fed policymakers agreed in September to start tapering the $120-billion monthly emergency pandemic support in either mid-November or mid-December, concluding about the middle of 2022.

The Federal Reserve moved aggressively early in the pandemic to ensure liquidity in the financial markets by cutting interest rates to banks to between 0% and 0.25% and buying mortgage-backed securities and U.S. Treasuries.

In recent weeks central bank officials said it is likely the economy will make "substantial further progress," allowing the Fed to abate its purchases. Officials outlined a path that reduces asset purchases by $5 billion a month and cuts the purchase of Treasury securities by $10 billion monthly.

Minutes of the Federal Open Market Committee meeting shows that its 18 members were split on the timing of interest rate hikes, with half the members making a case for one rate increase next year.

Daily Treasury Yield Curve Rates (Decade Trend)



"Inflation is elevated and is likely to remain so in the coming months before moderating" – Fed Chair Jerome Powell

Inflation is elevated and is likely to remain so in the coming months before moderating, Fed Chair Jerome Powell told congressional leaders in September. He added that as the economy improves and spending rebounds, upward pressure on prices is expected, particularly due to supply bottlenecks in some sectors. These effects have been larger and longer lasting than anticipated. But they will subside and as they do, inflation is expected to drop back toward the longer 2% goal. In remarks to senators Powell noted that GDP rose at a robust pace in the first half of the year and that growth is expected to continue at a strong pace in the second half. He reiterated that the Fed is committed to support the economy for a long as it takes to complete the recovery.

Minutes of the last FOMC meeting shows that central bank analysts believe that domestic financial conditions were little changed since its July report, on net, and remained highly accommodative. The spread of the Delta variant of the Covid virus weighed on the near-term growth outlook, and median respondents to the Open Market Desk's Survey of Primary Dealers marked down projections for gross domestic product growth and revised up projections for inflation this year. Nonetheless, expectations for the trajectory of growth beyond 2021 were little changed. Implied forward inflation compensation two to four years ahead based on Treasury Inflation-Protected Securities increased modestly over the intermeeting period. These announcements were broadly in line with market participants' expectations and elicited only a modest reaction in financial markets. In Latin America and emerging Europe, some central banks recently tightened policy to address rising inflation pressures. Investors remained focused on other vulnerabilities in emerging markets, and concerns had grown recently about the possible implications of developments in China.

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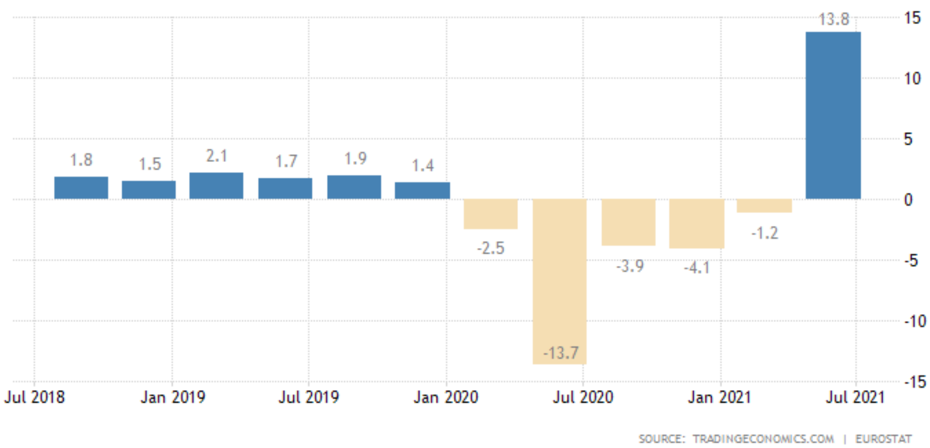
GLOBAL ECONOMY: TRENDING IN Q3 2021

Supply-chain disruptions and worsening health issues in emerging countries is making the International Monetary Fund less optimistic about the global economy, although reasonable growth is expected in the medium term.

In its recently published World Economic Outlook, the IMF said the global economy is projected to grow 5.9% in 2021 – 0.1% less than in its July forecast update – and 4.9% in 2022. The downward revision reflects a downgrade for advanced economies because of supply problems, and for low-income countries due to worsening pandemic conditions. This is partially offset by stronger near-term prospects among some commodity-exporting emerging market and developing economies. Employment generally is expected to continue lagging the recovery in output, the IMF said.

"This modest headline revision masks large downgrades for some countries," said Gita Gopinath, IMF chief economist. The United States is one of the countries in this position. The IMF has cut its growth estimates for the U.S. this year by 1 percentage point. Growth outlooks for Spain and Germany also were cut by 0.5 percentage points each and Canada's was reduced by 0.6 percentage points.

European Union GDP Annual Growth Rate



"'The outlook for the low-income developing country group has darkened considerably due to worsening pandemic dynamics" – IMF Chief Economist Gita Gopinath

Beyond 2022, however, the IMF forecasts a moderate global growth level of 3.3% over the medium term. "The outlook for the low-income developing country group has darkened considerably due to worsening pandemic dynamics," she said.

The global economic recovery is continuing but the fault lines opened up by Covid are appearing more persistent than expected. Vaccine access and early policy support are the principal drivers of the gaps.

Consumer prices are up substantially just in the past few months and rising inflation is heightening anxiety around the world. In the U.S., prices rose 5.4% in July compared to last year. It was the largest jump since 2008. In the eurozone, inflation hit a 13-year high in September. This has ramped up the pressure on central banks to ease off their monetary stimulus programs quicker than anticipated.

"Inflation risks are skewed to the upside and could materialize if pandemic-induced supply-demand mismatches continue longer than expected," the IMF report said. As a result, the IMF cautioned that, "although central banks can generally look through transitory inflation pressures and avoid tightening until there is more clarity on underlying price dynamics, they should be prepared to act quickly if the recovery strengthens faster than expected or risks of rising inflation expectations become tangible." "These divergences are a consequence of the 'great vaccine divide' and large disparities in policy support," Gopinath said.

"While over 60% of the population in advanced economies are fully vaccinated and some are now receiving booster shots, about 96% of the population in low-income countries remain unvaccinated," she said.

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