Third Quarter 2021 Economic Summary and Outlook

Third quarter 2021 GDP growth was only 2.1% following 6.7% growth in the second quarter, according to the revised Bureau of Economic Analysis announcement. Most of third quarter growth came from inventory accumulation while consumer spending was unusually weak with only 1.8% growth. Fiscal stimulus in the first half of 2021 waned after the second quarter, lowering disposable income. While accumulated savings provided a buffer for consumers, inflation and an uptick in pandemic concerns weighed on spending. The Fed continued expansionary policies keeping the Fed Fund rate near zero and maintaining a large bond purchasing program. The year-over-year growth rate of the M2 money supply was 13.01% at the end of the third quarter following a 23.72% growth rate last year. The long term average growth rate of M2 is only about 7%. Is does not yet appear as if the economy can generate a strong recovery without monetary and fiscal policy support.

The labor market shows mixed strength, even though payroll expansion hit a road bump in November. The unemployment rate dipped to 4.2% in November but only 210,000 jobs were created compared to an average of 582,000 jobs per month for the rest of this year. The labor force participation rate held steady at 61.8%. The combined effect of low labor productivity and wage gains resulted in an 8.3% gain in unit labor costs. Wage gains for the year are just under 5%, but high inflation prevented gains in real wages. Consumer sentiment hit a nine-month low in November, even before the Omicron virus was discovered. Annual inflation of 6% coupled with remnants of COVID restrictions presented hurdles for most households. Overall, there is discomfort due to a lack of confidence in the ability of leadership to manage supply chain challenges, energy prices and inflation, threats to the Ukraine, tension with China, southern border security, growing national debt, crime and domestic safety, public education, and the uncertain costs and benefits of unprecedented spending packages before Congress.

The ISM manufacturing index posted two straight months with below 50 readings. While 50 is the expansion benchmark, the index only suggests weakness at this point. A key issue going forward will be the extent to which the Omicron virus leads to disruptions in the domestic and global markets. The third quarter was off to a good start until the Omicron variant and the Fed's elevated concern for inflation came to light late in November. Retail sales increased 14.8% from last year and spending appeared robust going into the holiday season. Estimates for fourth quarter growth should be revised downward from a 5% forecast. The Fed is likely to begin tapering bond purchases in December with three expected hikes in the Fed Fund rate during 2022. As inflation estimates are revised upward, lenders are likely to increase borrowing rates, slowing the housing market and durable good spending going into 2022.

Headline inflation is likely to be lower in the fourth quarter as oil prices moderate due to lower demand linked virus concerns. Improvements in the supply chain also should eventually ease price pressures. However, inflation should track well ahead of the FED's 2.5% target. While equity prices are currently slumping, earnings strength and a lack of alternatives for positive real returns should help prevent permanent sell offs. Cash positions are likely to increase for the remainder of this year. The yield on 10-year Treasury notes edged lower to 1.36% at the time of the writing of this Outlook.

~~Transitory~~ Inflation and the Fed

Federal Reserve Chairman Jerome Powell recently backtracked from his position that inflation pressures were transitory. Consistent with our views in prior *Outlooks*, Powell now concedes that inflation pressures are building on the supply and demand side of the economy. Inflation has consistently exceeded the Fed target of 2.5% in all three quarters of 2021 and unprecedented fiscal stimulus, monetary stimulus, and global supply constraints support the inflation theme. The admission that inflation is likely to persist has set off speculation that the Fed will begin tapering its massive bond purchasing program this year. Credit conditions will also tighten as the Fed is likely to now raise the Fed Fund rate in small doses next year. The announcement by Powell raises the probability that all central banks will slowly reverse course. While central bank actions will be changing, the direction will still be expansionary, but at a slower pace. Economies have not fully recovered from the COVID, making any change in direction delicate.

While the Fed is posturing to be more hawkish on inflation, there is no guarantee that long term rates will rise rapidly soon. Traditionally, inflation expectations are built into long term interest rates to provide a real return. For example, the figure below illustrates the path of the 10-year Treasury yield for 2021. In every period, the yield is below analyst expectations for inflation, which consistently exceeded 2% over this period. Lower yields resulted from aggressive Fed bond buying (driving prices up and yields down) and global demand for investments in a strong currency. Going forward the Fed is likely to taper slowly and investors are likely to buy safer Treasury bonds as the pandemic lingers. Also, if the Fed pivots in a way that lowers expected inflation going forward, longer term rates would stay low, to the extent that expected inflation is part of the long term yield. If the Fed begins to raise the Fed Fund rate, the yield curve is likely to flatten with shorter term rates rising more than long term rates.

Figure U. S. Treasury 10-Year Yields for 2021

Source: U. S. Treasury, FRED

What remains to be seen is the fallout from any reversal of monetary and fiscal policy easing. The markets have become addicted to easy money and low interest rates while consumers have a similar addiction to transfer payments. These addictions must be managed carefully. From an equity market perspective, the key is how the balance between inflation and growth changes. If the Fed fully focusses on inflation and away from growth the equity markets will take a big hit.

This bearish view will come to pass if the Fed makes a policy mistake and overreacts. The likely outcome is a modest Fed approach to inflation unless economic growth accelerates beyond 4%.

The Downside of Globalization

Globalization links economic performance of countries based on comparative advantages in production. Economic arguments in favor of globalization revolve around the benefits of free trade and optimal use of resources. Wealth is expanded through trading for goods that can be obtained cheaper than producing them domestically. This theory is generally attributed to economist Adam Smith but the reality of globalization has been ongoing and has picked up speed since World War II. Increased wealth is the benefit of globalization but there are downside risks that are now becoming more apparent, especially given our experience with COVID. Economies are now so interconnected and supply chains have so many links that issues in any country for any reason affect the end consumer of products.

For example, the U. S. depends heavily on China for products and inputs for production. At the same time, relations between the two countries are likely to be at odds with each other far into the future. China has severe human rights violations that help support a comparative advantage in labor costs. China's developing country status allows more pollution in production, offering cheaper production costs and higher use of coal. While the U. S. currently has magnified social justice awareness and environmental concern domestically, social injustices and pollution elsewhere contribute to cheaper goods in the U. S. In effect, globalization allows the U. S. to export social injustice and pollution in exchange for cheaper goods.

Globalization hinges on the willingness of trading partners to focus on the economic advantages of trade without concern from being locked out from the supply of goods and inputs. National defense and infant industry arguments have long been used to protect certain domestic industries, but not key areas like energy or medicines. Consumers are likely to cope with a disruption of treadmill supplies but not when the supply of key ingredients or products are affected. Recent spikes in gasoline prices demonstrate a vulnerability to globalization of oil supplies. Currently, fossil fuels account for as much as 85% of energy use in the U.S. Prior experience with OPEC illustrates the danger of dependence on other countries for energy. The push for energy independence was behind initiatives such as offshore drilling, shale drilling, domestic pipeline development, and leasing government lands for drilling. The current political war on fossil fuels and dismantling of many energy independence initiatives increases our dependence on OPEC, as President Biden's recent pleas to OPEC illustrate. Globalization is likely to increase as countries coordinate efforts on the environment and businesses become even more global. The downside risks of globalization are likely to increase with more vulnerable supply chains and differences with respect to social and political views.

Summary of Key Economic Data

***GDP** – The revised third quarter GDP growth rate slowed to only 2.1% following stimulus driven growth of 6.7% in the second quarter. Almost all of third quarter growth came from inventory accumulation, which is a transitory component of GDP. Consumer spending grew at a rate that was well below prior quarters. Nonresidential fixed investment and state and local government spending aided growth but residential fixed investment, federal government spending, and trade were all drags. Without the massive fiscal stimulus payments of prior quarters, real disposable income fell at an annual rate of 4%. The saving rate fell to 9.6% from 10.9% in the prior quarter, but the rate remains high by historic standards. Fourth quarter growth is expected to be stronger than the third quarter, but high energy prices, inflation and concerns over new virus variants cloud the future.*

- The Table below summarizes growth in GDP and GDP components since the first quarter of 2019. Rebounds from the lockdowns took place in the third and fourth quarters of 2020 while stimulus spending was largely responsible for the high growth in the first and second quarters of 2021. The third quarter of 2021 is more representative of economic performance without significant fiscal stimulus.

Table 1. U. S. GDP and GDP Components (Percent Change at an Annual Rate)

	2019				2020				2021		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Gross Domestic Product	2.40	3.20	2.80	1.90	-5.10	-31.20	33.80	4.50	6.30	6.70	2.10
Consumption Expenditures	0.43	2.37	2.12	1.13	-4.79	-24.10	25.51	2.26	7.44	7.92	1.18
Private Domestic Inv.	1.13	0.48	0.22	-1.18	-0.92	-9.64	11.71	4.01	-0.37	-0.65	1.93
Fixed Investment	0.64	1.06	0.54	-0.19	-0.41	-5.63	4.88	2.92	2.25	0.61	-0.20
Nonresidential	0.63	0.90	0.40	-0.23	-1.14	-4.28	2.72	1.57	1.65	1.21	0.21
Residential	0.00	0.15	0.14	0.04	0.73	-1.36	2.16	1.34	0.60	-0.60	-0.41
Change in Inventories	0.49	-0.57	-0.32	-0.99	-0.51	-4.01	6.84	1.10	-2.62	-1.26	2.13
Net Exports	0.39	-0.50	0.07	1.43	-0.05	1.53	-3.25	-1.65	-1.56	-0.18	-1.16
Government Expenditures	0.47	0.86	0.36	0.52	0.63	0.97	-0.19	-0.09	0.77	-0.36	0.16

Source: Bureau of Economic Analysis

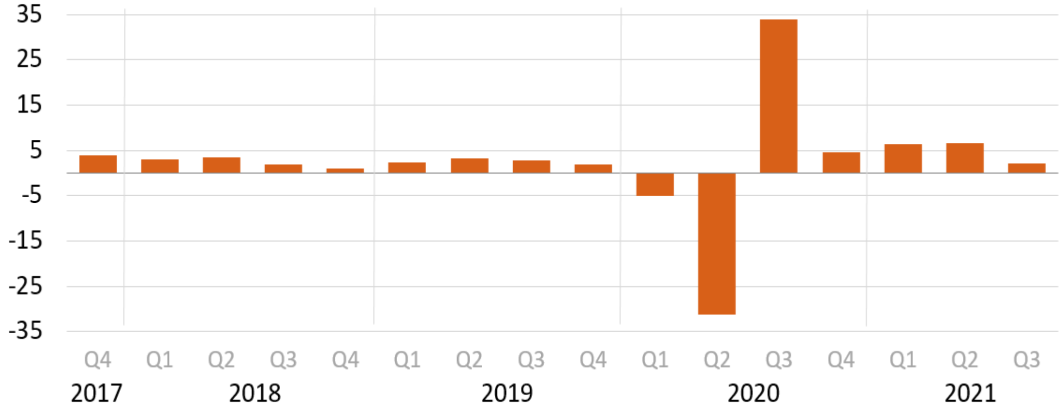
- Consumer spending, which makes up about two-thirds of GDP, grew at a modest 1.18% annual rate in the third quarter. Consumers faced an uptick in the Delta virus and an increase in inflation, both serving to dampen real spending.

- Real disposable income fell at an annual rate of 4% in the third quarter, largely due to the phase out of stimulus spending.

- Profits gained 4.3% in the third quarter following an increase of 10.5% in the prior quarter.

- Figure 1 illustrates the growth in real GDP since the end of 2017. The graph shows that the COVID recession was largely offset by a big rebound as lockdowns eased. Going forward, growth will be boosted somewhat by recent infrastructure spending plans and continued monetary easing, although at a slower rate of monetary expansion. COVID virus variants, higher energy prices, and poor supply chain management pose threats to growth in the near future.

Figure 1. Real GDP by Quarter (Percentage Change from Prior Quarter)



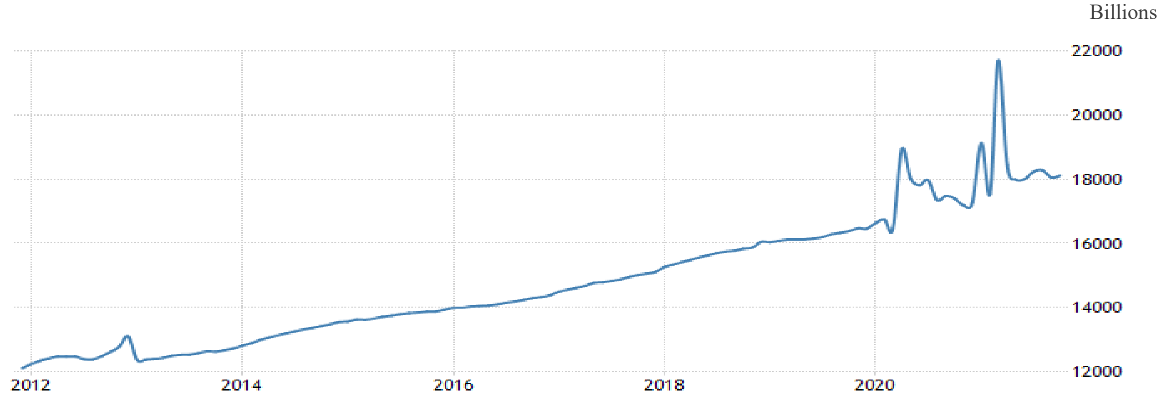
Source: Bureau of Economic Analysis

- COVID infections and restrictions continue to dampen growth in the U. S. and globally, especially with the recent Omicron variant outbreak. Many of the government assistance payments such as forgivable loans to businesses, grants to state and local governments, and social benefits to households have all been tapered away. Overall, it appears as if the economy is not prepared for strong growth without continued artificial government monetary and fiscal expansionary policies, which are inflationary given supply constraints.

Income, Savings, and Sales – *Real disposable income fell by 5.6% in the third quarter as government transfer payments no longer provided a supplement. The saving rate has been falling and is now 7.3% in October. Both disposable income and saving have been volatile in 2021 as transfer payments ebb and flow. Consumers have accumulated savings to spend in the fourth quarter but the economy is not generating enough growth in disposable income to drive a strong rate of growth in spending into 2022.*

- Real disposable personal income declined by 5.6% in the third quarter following a decline of 30.2% in the second quarter. Disposable personal income is the income available for spending or saving after taxes. Figure 2 below shows the disposable personal income in billions of dollars since 2012. The volatility starting in 2020 reflects the temporary nature of government transfer payments on disposable income and what appears to be a return to a longer term trend following the tapering of transfer payments.

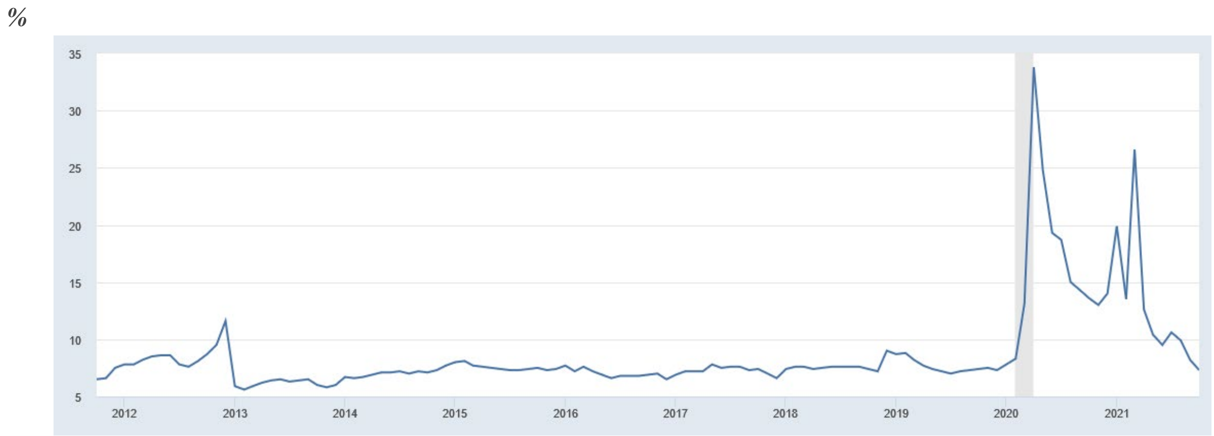
Figure 2. U. S. Disposable Personal Income (Billions of U.S. dollars)



Source: Bureau of Economic Analysis

- The U.S. personal saving rate, which is personal saving as a percentage of disposable personal income, was 9.6% in the third quarter. The saving rate is falling as government transfer payments dry up. For September the saving rate was 8.2% and the rate fell to 7.3% in October. The time line for the personal saving rate since 2012 appears in the figure below.

Figure 3. U. S. Personal Saving Rate



Source: Bureau of Economic Analysis, FRED

- Personal income rose by only 0.5% on a month over month basis in October. Wage and salary income provided most of the gain. The slower growth in income was largely due to the reduction in government transfer payments. Unemployment insurance payouts shrank by more than 50% from September to October.

- Advance estimates of U.S. retail and food services sales for October 2021 by the Census Bureau, adjusted for seasonal variation and holiday and trading-day differences, increased 1.7% from the previous month, and 16.3% above October 2020.

- Total sales for the August 2021 through October 2021 period were up 15.4% from the same period a year ago. The August 2021 to September 2021 percent change was revised up from 0.7% to up 0.8%.

- Retail trade sales were up 1.9% from September 2021, and up 14.8% above last year. Gasoline station sales were up 46.8% from October 2020, while sales from food services and drinking places were up 29.3% from last year. The figure below illustrates the growth of retail sales from the start of 2017 to present.

Figure 4. Retail Sales in Millions of Dollars

Source: U. S. Census Bureau, FRED

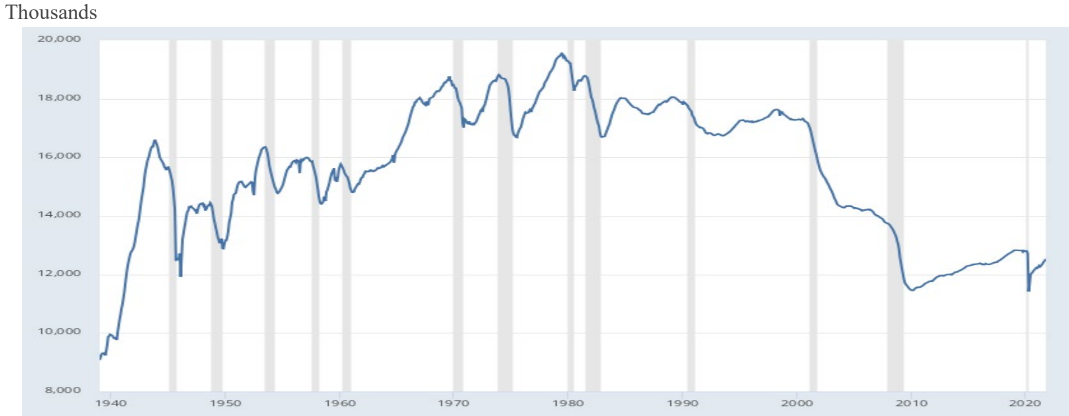
***Production and Manufacturing** – Industrial production gained 1.6% in October after falling 1.3% in September. The ISM manufacturing index fell below the benchmark of 50 in both August and September, but based on past data, there is not a clear signal of a contraction. Nevertheless, a long run decline in hiring for manufacturing jobs continues as globalization pushes the U.S. toward a service economy. Capacity utilization improved in September but remains well below full employment utilization.*

- While U.S. industrial production fell 1.3% in September, due in part to the lingering effects of Hurricane Ida, there was a bounce back of 1.6% in October. Manufacturing production gained 1.2% in October following declines in each of the prior two months. Motor vehicle and parts production were the largest contributors to manufacturing growth.

- The ISM manufacturing index, also called the purchasing managers' index (PMI), is a monthly indicator of economic activity based on a survey of purchasing managers at more than 300 manufacturing firms. The composite index fell to 47.8 in September from 49.1 in August. Technically, an index below 50 suggests a contraction in the economy, but history suggests that readings below 42.9 are more predictive of contractions.

- Among the key components of the ISM index, the production index was 47.3 in September, down from 49.5 in August. The manufacturing employment index fell to 46.3 in September from 47.4 in August. Figure 5 illustrates the long run decline in U. S. manufacturing employment.

Figure 5. Manufacturing Employees (Thousands of Employees Seasonally Adjusted)



Source: Bureau of Labor Statistics

- Durable-goods orders fell in 0.5% in October. Excluding transportation, durable-goods orders rose 0.5%. Durable-goods inventories increased 0.6% in October.

- Capacity Utilization in the United States increased to 76.4% in October from 75.2% in September of 2021. The utilization rate remains well below the pre-recession level.

Figure 6. U. S. Industrial Capacity Utilization

Source: Board of Governors of the Federal Reserve, FRED

- Business inventories increased by 0.7% from August to September. Manufacturing inventories climbed 0.8%, wholesale inventories grew 1.4%, and retail inventories declined by 0.2%. The total business inventory-to-sales ratio was 1.26, unchanged from the prior month but well below last year's ratio of 1.35, largely due to supply chain lags. The Figure below shows the pattern of the inventory to sales ratio before and after the COVID recession.

Figure 7. Total Business Inventory to Sales Ratio

%

Source: U. S. Census Bureau, FRED

Labor Market and Employment *- Labor market data are mixed, even though the unemployment rate fell to 4.2% in November. Payroll gains in November were only 210,000 jobs, largely due to declines in retail trade and government with only modest gains in leisure/hospitality. Payroll expansion averaged 582,000 jobs per month so far this year. The labor force participation rate ticked up slightly to 61.8%. Unit labor costs increased 8.3% in the third quarter, adding to cost-push elements of inflation. Declining labor productivity is a key factor in rising unit labor costs.*

- Average hourly earnings for employees on private nonfarm payrolls increased 0.3% in November to $31.03. November had the smallest increase in average hourly earnings since March.

- The unemployment rate fell to 4.2% in November. Even so, approximately 7.4 million unemployed workers continue to seek jobs. Both measures are improving from their highs at the end of the February-April 2020 recession, but remain above the pre-recession unemployment level of 3.5% and with 5.7 million unemployed.

Figure 8. U. S. Headline Unemployment Rate

%

Source: Bureau of Labor Statistics

- Among the unemployed, 2.1 million lost permanent jobs while 1.1 million were temporary layoffs. For October, the number of long-term unemployed, who were jobless for 27 weeks or more, fell by 357,000 to 2.3 million. Nevertheless, long-term unemployment is 1.2 million higher than in February 2020 and accounts for 31.6% of the total unemployed in October.

- The labor force participation rate was unchanged at 61.6% in October. The participation rate is 1.7% lower than in February 2020. The employment to population ratio reached 58.8% in October, which is below the 61.1% rate in February of 2020.

- About one million people wanting a job were not counted as unemployed because they were not actively looking for jobs during the four weeks of the survey period.

- Total nonfarm payroll employment increased by 531,000 in October and has averaged 582,000 per month so far this year. Employment is down by 4.2 million jobs from the pre-pandemic level in February 2020.

- Average hourly earnings grew 4.9% over the past 12 months, reaching $30.96 in October. The average workweek for all employees on private nonfarm payrolls fell to 34.7 hours.

- Unit labor costs in the nonfarm business sector increased at an annual rate of 8.3% in the third quarter of 2021, reflecting a 2.9% increase in hourly compensation and a 5.0% decrease in productivity. For the last four quarters, unit labor costs increased 4.8% over the last four quarters. Increases in hourly compensation tend to increase unit labor costs and increases in productivity tend to reduce them.

- The figure below shows the history of U. S. nonfarm labor productivity.

Figure 9. Nonfarm Business Labor Productivity for all Employed Persons (Percentage Change from Prior Quarter on a Year over Year Percent)

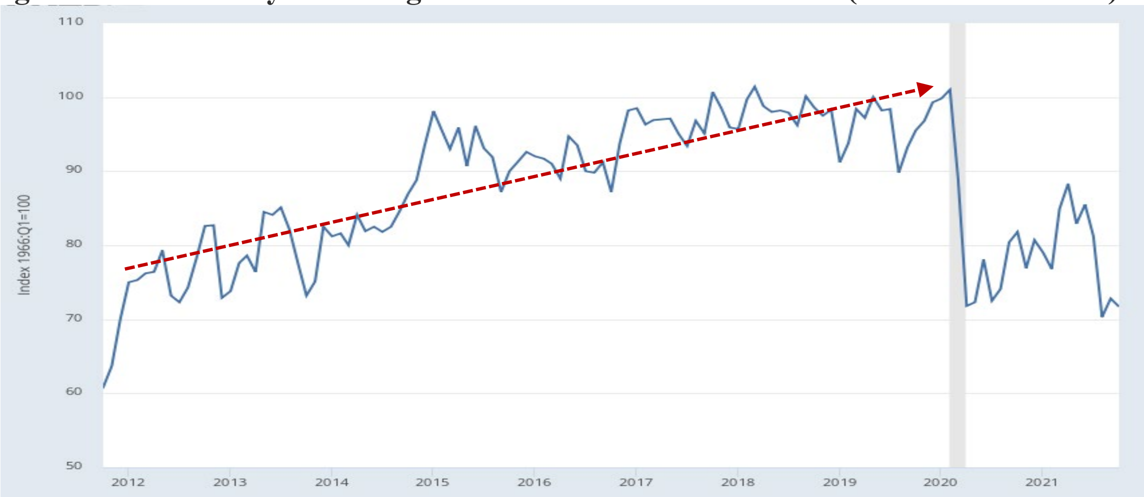
Sentiment and Confidence *– Consumer sentiment and confidence in the overall economy play an important role in shaping consumer decisions and future economic performance. Consumer confidence fell to a nine-month low in November based on results from the University of Michigan and the Conference Board. Consumers grew pessimistic due to rising prices and concerns over the Delta variant of the coronavirus. The Conference Board index is tilted toward the labor market, which helps explain why it provides more optimistic views of the economy now while the labor market is relatively strong. The surveys for the Michigan and Conference Board surveys were prior to the Omicron virus variant and the most recent disappointing payroll data for November. Economists expect a good holiday season fueled by pent up demand and accumulated savings. Nevertheless, confidence will be low going into 2022.*

- U.S. consumer confidence fell to a new pandemic-era low in November, according to the University of Michigan survey. Confidence suffered from acceleration in inflation (especially gasoline prices), increased concern for the Delta virus, worries about the debt ceiling, Russian military buildup in the Ukraine, tension with China over human rights, inability to manage the security of the southern border, and uncertain consequences of massive government spending bills.

- The University of Michigan Confidence index fell to 67.4 in November from 71.7 in October. The index is now at a decade low. The decline was led by expectations, which fell 4.4 points from October. The present conditions index fell 4.1 points.

- The 12-month inflation expectation component of the Michigan survey increased to 4.9% from October's 4.8%. The five-year inflation expectations component of the survey increased to 3% from 2.9%.

Figure 10. University of Michigan Consumer Sentiment Index (Index=100 in 1966)



Source: "Surveys of Consumers, University of Michigan, University of Michigan: Consumer Sentiment © [UMCSENT], retrieved from FRED, Federal Reserve Bank of St. Louis

- The Conference Board reported that its consumer confidence index fell to 109.5 from 111.6 in October. November's reading is the lowest since the index stood at 95.2 in February. The Conference Board survey was prior to news about the Omicron virus variant, which should dampen expectations. Overall, the Conference Board report is consistent with the University of Michigan survey results. Consumer confidence is falling as COVID and its variants appear to be with us longer than expected and inflation emerged well before the economy reached full employment.

- The Conference Board's present situation index, which measures consumers' assessment of current business and labor conditions, fell to 142.5, down from 145.5 in October. The expectations index fell to 87.6 in November from 89.0 in October.

Inflation – *Fed Chairman Powell finally changed his position on inflation and recognized that rising prices are not transitory. Supply and demand side pressures are likely to extend well into 2022. Tapering of bond purchases is now likely to begin by the end of 2021. All measures of inflation remain well above Fed targets. The GDP deflator increased 5.5% in the third quarter following a 5.8% gain in the second quarter. The PCE inflation index increased 5.3% in the third quarter compared to a 6.5% increase in the second quarter. The Consumer Price Index for All Urban Consumers increased 6.2% from October 2020 to October 2021, the largest 12-month increase since the period ending November 1990. Consumers are especially distressed by the high price of energy, which increased 30% over the past 12 months.*

- The price index for gross domestic purchases increased 5.5% in the third quarter, following an increase of 5.8% in the second quarter. The PCE price index increased 5.3% in the third quarter, compared with an increase of 6.5% in the second quarter. Excluding food and energy prices, the third quarter PCE price index increased 4.5%, compared with an increase of 6.1% in the second quarter. Table 2 below illustrates quarterly PCE inflation and the jump in 2021.

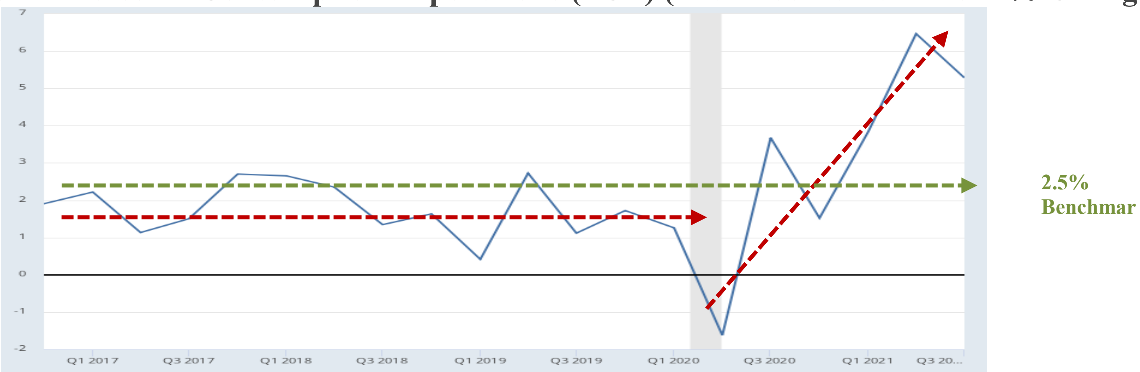
Table 2. Personal Consumption Expenditure (PCE) by Quarter (Annual % Change)

	Q I 2021	Q II 2021	Q III 2021	Q IV 2021	Q I 2021	Q II 2021	Q III 2021
PCE Annual % Change	1.3	-1.6	3.7	1.5	3.8	6.5	5.3

Source: Bureau of Economic Analysis

- Figure 11 illustrates the movement of inflation over the past five years, measured by the PCE inflation index. Prior to the COVID recession, inflation was relatively stable and below the Fed inflation target of 2.5%. Since the recession, massive fiscal and monetary policy expansion combined with pent up demand due to a lockdown all served to fuel inflation. Supply chain constraints linked to labor shortages, higher fuel costs, and poor synchronization of production and delivery are not going away soon.

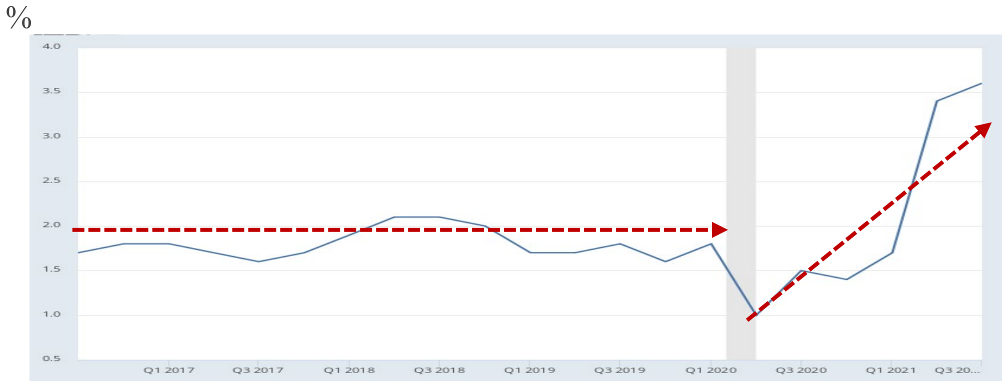
Figure 11. Personal Consumption Expenditure (PCE) (Last Five Years Annual % Change)



Source: Bureau of Economic Analysis, FRED

- The core PCE Price Index excludes food and energy, since these components tend to be volatile and less representative of underlying trends. Figure 12 below shows the pattern of the Core PCE over the past five years.

Figure 12. Core PCE (Excluding Food and Energy) Annual Percentage Change by Quarter

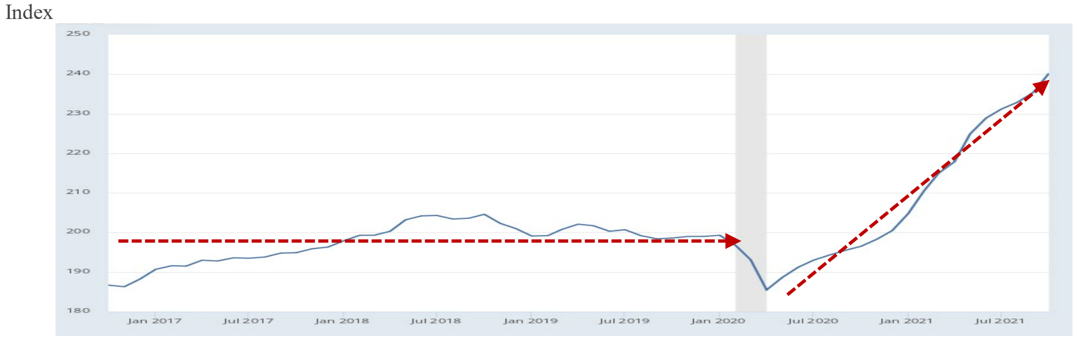


Source: Bureau of Economic Analysis, FRED

- The CPI increased a whopping 0.9% in October. Excluding food and energy, the CPI was up 0.6% in October compared with a 0.2% gain in September. Over the past 12 months the CPI increased 6.2% and the core CPI increased 4.6%. The core CPI gain in October is the largest 12-month increase since August of 1991. The **Consumer Price Index (CPI)** is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

- The **Producer Price Index (PPI)** measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services. The U.S. Producer Price Index rose 0.6% in October. The Figure below illustrates the movement of the PPI over the last five years. Inflationary pressures since the COVID recession are clearly illustrated.

Figure 13. Producer Price Index Over the Past Five Years (Index = 100 in 1982)



Source: Bureau of Labor Statistics

***Housing** - According to the Federal Housing Finance Agency Housing Price Index (FHFA HPI), house prices gained 18.5% from the third quarter of 2020 to the third quarter of 2021. The S&P/Case-Shiller index gained 19.5% for the same period. Housing price indexes are currently at historic levels. Nevertheless, momentum for house prices appears to have peaked at the end of the second quarter with slower growth rates in the third quarter. Strong demand continues due to an improving labor market and low mortgage rates. However, mortgage rates are expected to rise as we go into 2022, making houses less affordable.*

- U.S. residential investment is slowing. Housing starts fell 0.7% in October and starts in September were revised lower. Most of the slide in starts was due to a decline in single-family housing, which fell 3.9% to 1.039 million annualized units.

- The National Association of Realtors (NAR) pending home sales index gained 7.5% in October to offset losses in September. Overall, the index remains 1.4% below its year-ago level. Existing-home sales were up 0.8% in October while single-family home sales increased 1.3% on a monthly basis. New-home sales increased from 742,000 in September to only 745,000 in October. The months of supply increased to 6.6 in October from 6.1 in September.

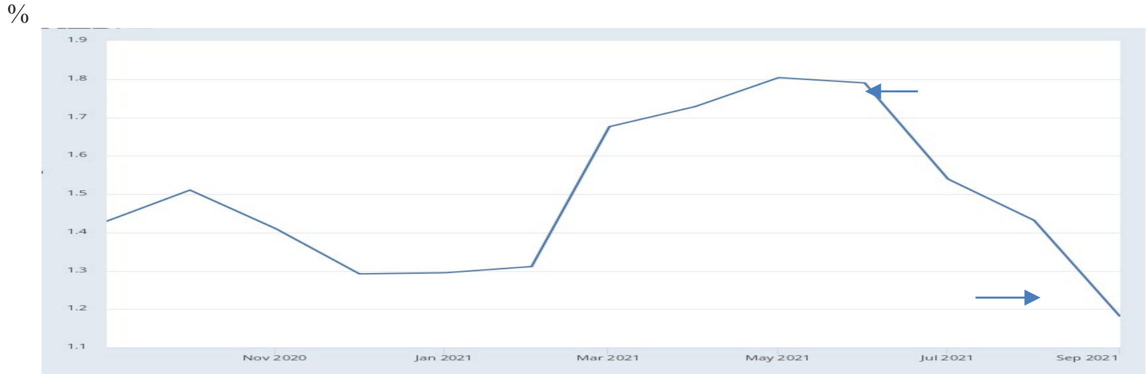
Figure 14. New Single-Family Homes Sold (Thousands of units)

Source: Census, HUD, FRED

- Housing prices appreciated rapidly over the last year, but the momentum appears to be breaking. For the last four quarters ending in the third quarter of 2021, housing prices increased 18.5% based on the Federal Housing Finance Agency House Price Index. The S&P CoreLogic Case-Shiller U.S. National Home Price Index® rose 19.5% year-over-year in September. House price appreciation is unsustainable at such high rates. Overall, average hourly wages in the U.S. increased less than 5%, making house price appreciation about four times faster than wage appreciation. Consumers are gaining job security as the labor market improves, but rising mortgage rates and modest growth in wages will inevitably slow house price gains.

- Figure 15 below illustrates the percentage change per month in the S&P/Case Shiller Home Price Index over the past year. The rate of growth in housing prices clearly peaked in or around June.

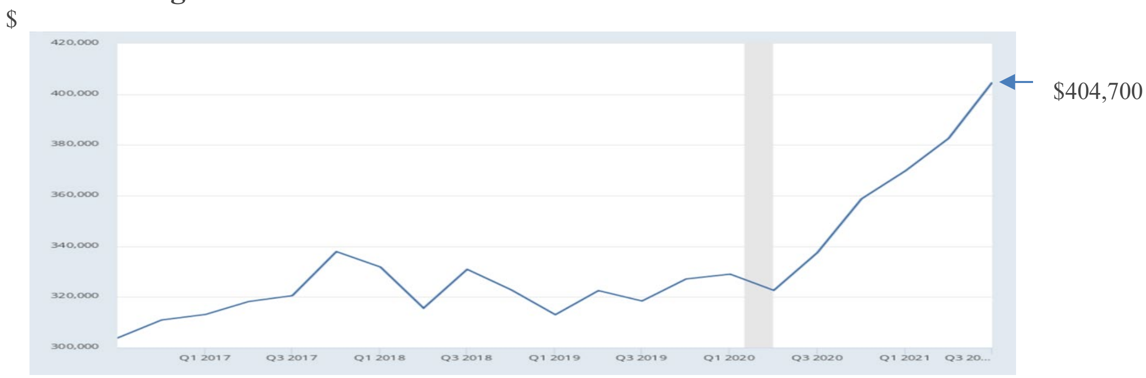
Figure 15. S&P/Case Shiller U. S. National Home Price Index (Percent Change per Month)



Source: Dow Jones Indices LLC, FRED

- The median U.S. home price surpassed $400,000 in the third quarter of 2021. The median home price hit $404,700 compared to $358,700 on the third quarter of 2020 (see Figure 16). While most economists believe the rapid rise in home prices will wane, there is a relatively low inventory of homes for sale that should help prevent a rapid decline.

Figure 16. Median Sales Price of Houses Sold in the U. S.



Source: U. S. Census, FRED

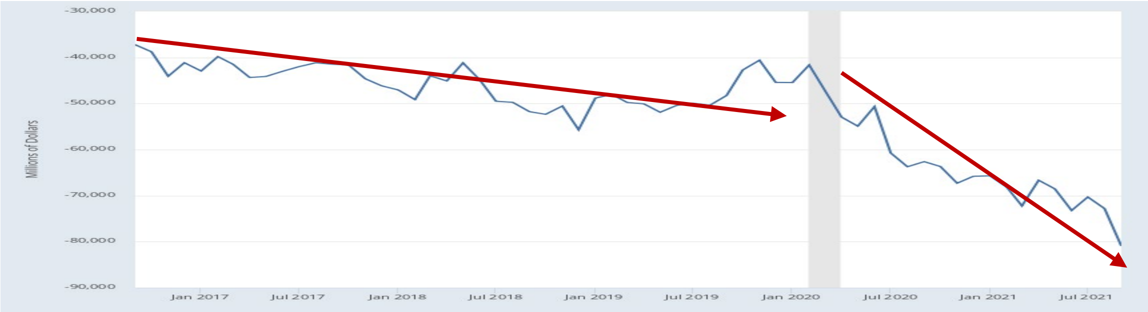
***U. S. International Trade** – The U. S. trade balance reached a record low in September of 2021. Trade continues to be a drag on growth. Trade deficits with China and Mexico represent the largest components of the imbalance. Oil imports increased as the U. S. has now lost its energy independence. OPEC will not agree to change production plans to ease oil prices, clearly hoping to recoup losses due to COVID shutdowns and slumping demand over the past two years. The current administration should not expect help from OPEC to lower prices.*

- The U.S. Balance of Trade in the United States reached a record deficit of $80,934,000,000 in September of 2021. The deficit with China increased $3.4 billion to $31.5 billion and the gap with Mexico widened by $2.3 billion to $8.8 billion. The record high for the U. S. Balance of Trade was $1,946,000,000 in June of 1975. Since 1976, the U. S. has been consistently running a trade deficit, largely due to increased imports of oil and consumer products.

- Globalization shifted manufacturing from the U. S. to other counties, primarily China and Mexico. The largest U. S. trade deficits tend to be with China, Mexico, Germany, Japan, Ireland, Vietnam, and Italy. U. S. surpluses tend to be with Hong Kong, Netherlands, Australia, United Arab Emirates, Belgium, Brazil, and Panama. China is the top U. S. trading partner with about 16% of total trade followed by Canada with about 15% and Mexico with 15%.

- Most of the increase in U.S. import prices in October were due to higher energy costs. Overall, import prices were up 1.2%. Imported petroleum prices increased 8.1% in October following a 3.8% increase in September. The figure below illustrates the chronic deficit in the U. S. trade balance and the accelerated decline in the post COVID period.

Figure 17. U. S. Trade Balance of Goods and Services Over the Past Five Years



Source: U. S. Census Bureau, Bureau of Economic Analysis, FRED