Investor Advisory Committee on Financial Markets
Member Presentation Materials

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Q4 2021 IACFM Meeting
Discussion Materials

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Situation Overview

- **Economy has made substantial progress towards the Fed's employment and inflation targets**
- **Economy is likely to experience a significant boost as we fully emerge from the pandemic, which is not yet reflected in employment and inflation figures**
- **Government has provided an unparalleled level of economic stimulus during the pandemic and is likely to provide additional stimulus**
  - $5.1tr of stimulus since the beginning of the pandemic (~25% of GDP)
  - Future infrastructure and "Build Back Better" spending may be $2tr to $3tr (10% to 15% of GDP)
- **Fed funds rate at historically low levels**
- **Current Fed policy is to begin tapering shortly but wait on raising interest rates until further evidence of progress on employment and continued inflation**

A "wait and see" approach to raising interest rates creates significant risks given the substantial progress to date on employment and inflation combined with the unprecedented economic backdrop

Substantial Progress Towards Full Employment

More than 25 million jobs were lost due to the pandemic between February and April 2020, but the economy has since recovered 20 million jobs (~80%)

Current vs Pre-Pandemic Employment Summary (numbers in millions):

	Feb-20	Sep-21	Difference
Total employed in labor force	**158.7**	**153.7**	**(5.1)**
Unemployed in labor force	**5.7**	**7.7**	**2.0**
Headline U-3 unemployment rate	***3.5%***	***4.8%***	***1.3%***
U-6 unemployment rate [1]	*7.0%*	*8.5%*	*1.6%*
Total civilian labor force	**164.4**	**161.4**	**(3.1)**
Labor force participation rate	*63.3%*	*61.6%*	
Total civilian non-institutional population (16+)	**259.6**	**261.8**	**2.1**
Employed / Population	*61.1%*	*58.7%*	

Total employment is only five million jobs lower today than its pre-pandemic level in February 2020

Source: Bureau of Labor Statistics

(1) U-6 unemployment rate represents total unemployed, plus all persons marginally attached to the labor force, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all persons marginally attached to the labor force

Robust Pace of Monthly Employment Additions

At the current pace of ~500K monthly job additions, we expect the five million employment gap to pre-pandemic levels to close within the next 10 months

Monthly Employment Additions (numbers in thousands):

	Monthly Additions							Monthly
	Mar-21	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Average
Nonfarm payroll employees	785	269	614	962	1,091	366	194	612
Farm workers / proprietors / other[1]	(176)	59	(170)	(980)	(48)	143	332	(120)
Total employed in labor force	609	328	444	(18)	1,043	509	526	492

Current employment figures do not yet reflect the full impact of the ending of unemployment benefits, which began to expire through August and September

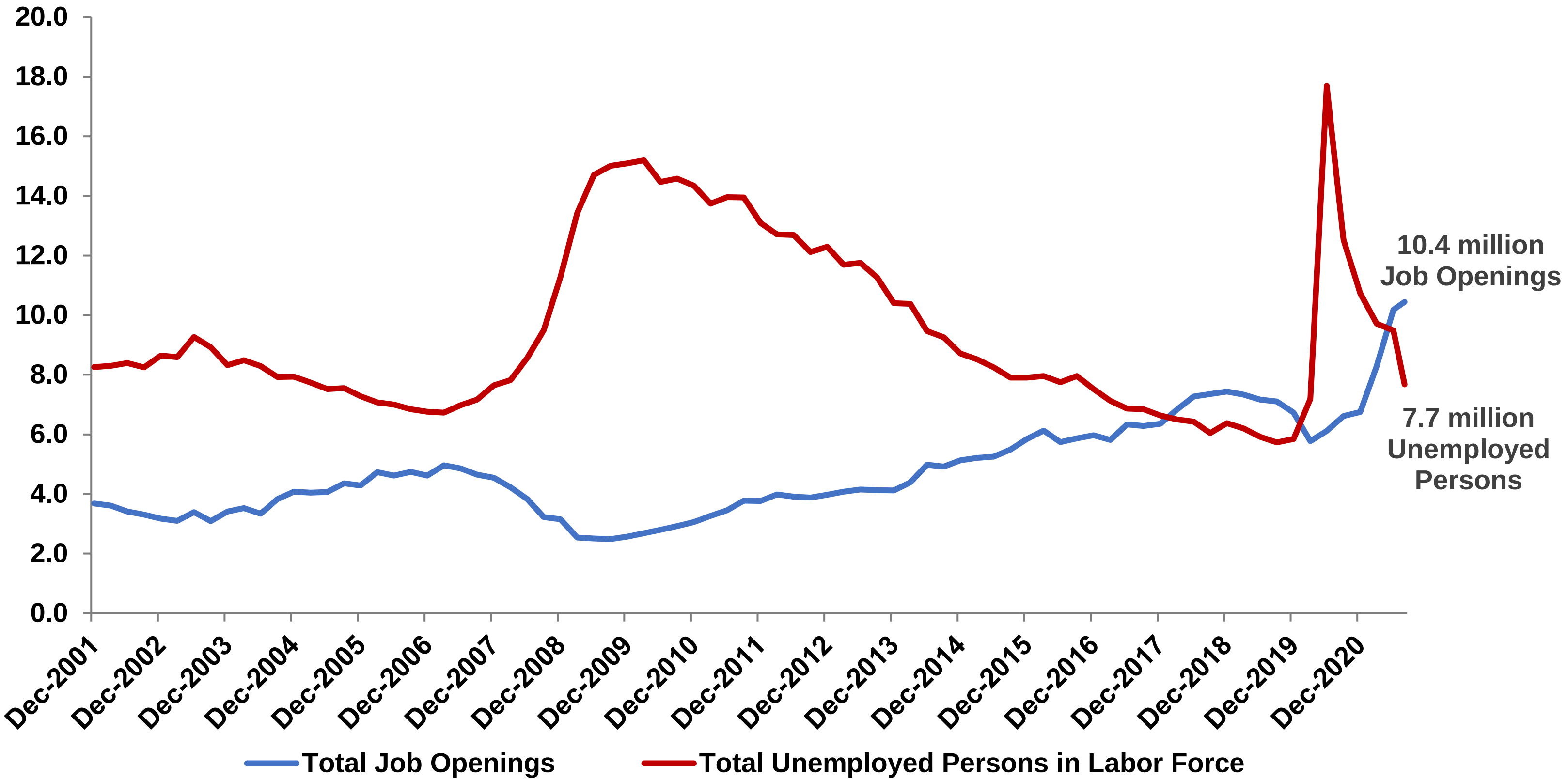
Source: Bureau of Labor Statistics

(1) Includes agricultural workers, unincorporated self-employed workers, private household workers and other employment categories that are reflected in the Bureau of Labor Statistics' Household Survey but are excluded from the Establishment Survey of non-farm businesses

Job Openings at Historic Highs

There are currently 10.4 million job openings in the economy, an all-time high level, and 2.8 million more openings than the number of unemployed persons

Number of Job Openings and Total Unemployed Persons in Labor Force (numbers in millions):



Source: Bureau of Labor Statistics

COVID-Impacted Sectors Account for Majority of Employment Shortfall

COVID-impacted industries such as leisure & hospitality and education account for a majority of the employment gap to pre-pandemic levels despite representing less than a quarter of total employment

<u>Current vs Pre-Pandemic Employment Levels by Sector (numbers in millions):</u>

			Difference			Category as % of Total
	Feb-20	**Sep-21**	**#**	**% Change**	**% Contribution**	**Employees**
Leisure & hospitality	16.9	15.3	(1.6)	(9%)	32%	11%
State & local, education	10.6	10.1	(0.5)	(5%)	10%	7%
Private education services	3.8	3.6	(0.2)	(5%)	3%	2%
Nursing and residential care	3.4	3.0	(0.4)	(13%)	8%	2%
Industries most impacted by COVID	**34.7**	**32.0**	**(2.7)**	**(8%)**	**53%**	**22%**
All other industries	**124.0**	**121.7**	**(2.4)**	**(2%)**	**47%**	**78%**
Total employed in labor force	**158.7**	**153.7**	**(5.1)**	**(3%)**	**100%**	**100%**

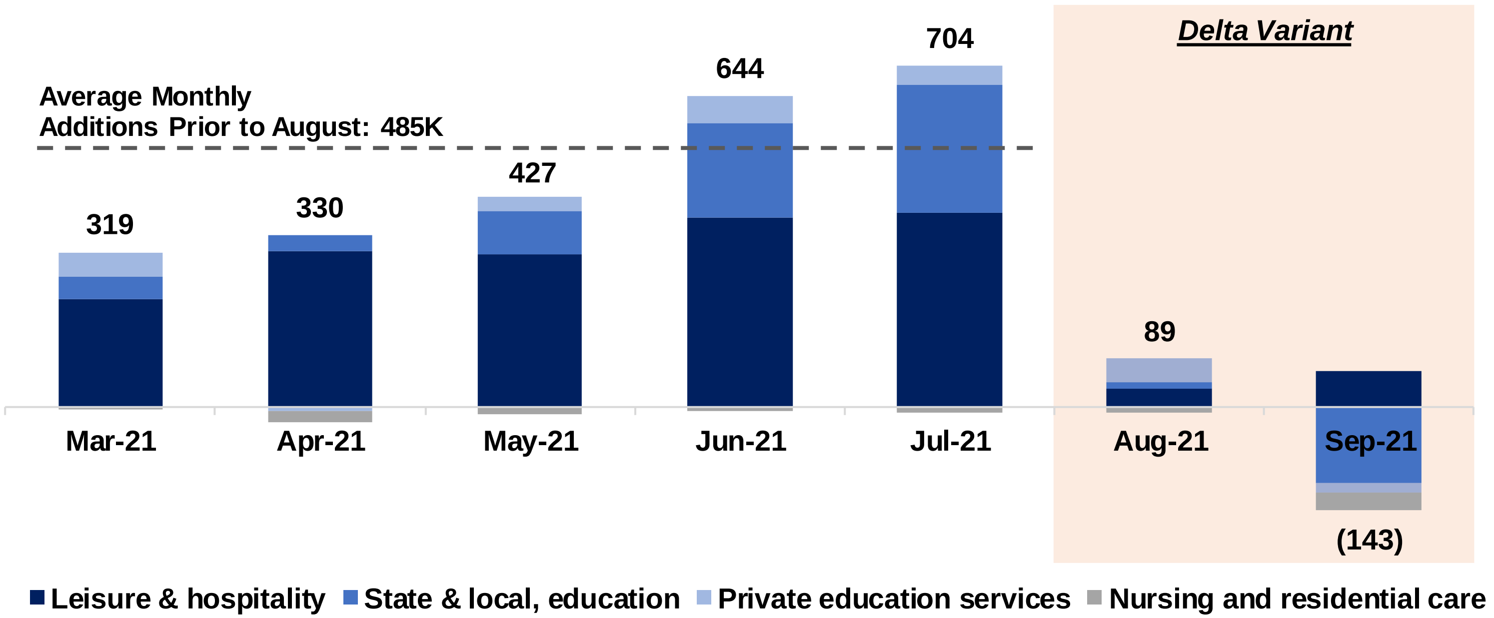
Source: Bureau of Labor Statistics

(1) Includes agricultural workers, unincorporated self-employed workers, private household workers and other employment categories that are reflected in the Bureau of Labor Statistics' Household Survey but are excluded from the Establishment Survey of non-farm businesses

COVID-Impacted Sectors Poised for Continued Recovery As Delta Variant Subsides

COVID-impacted industries were a material contributor to overall employment growth prior to a slowdown in August and September

Monthly Employment Additions in Industries Most Impacted by COVID (numbers in thousands):

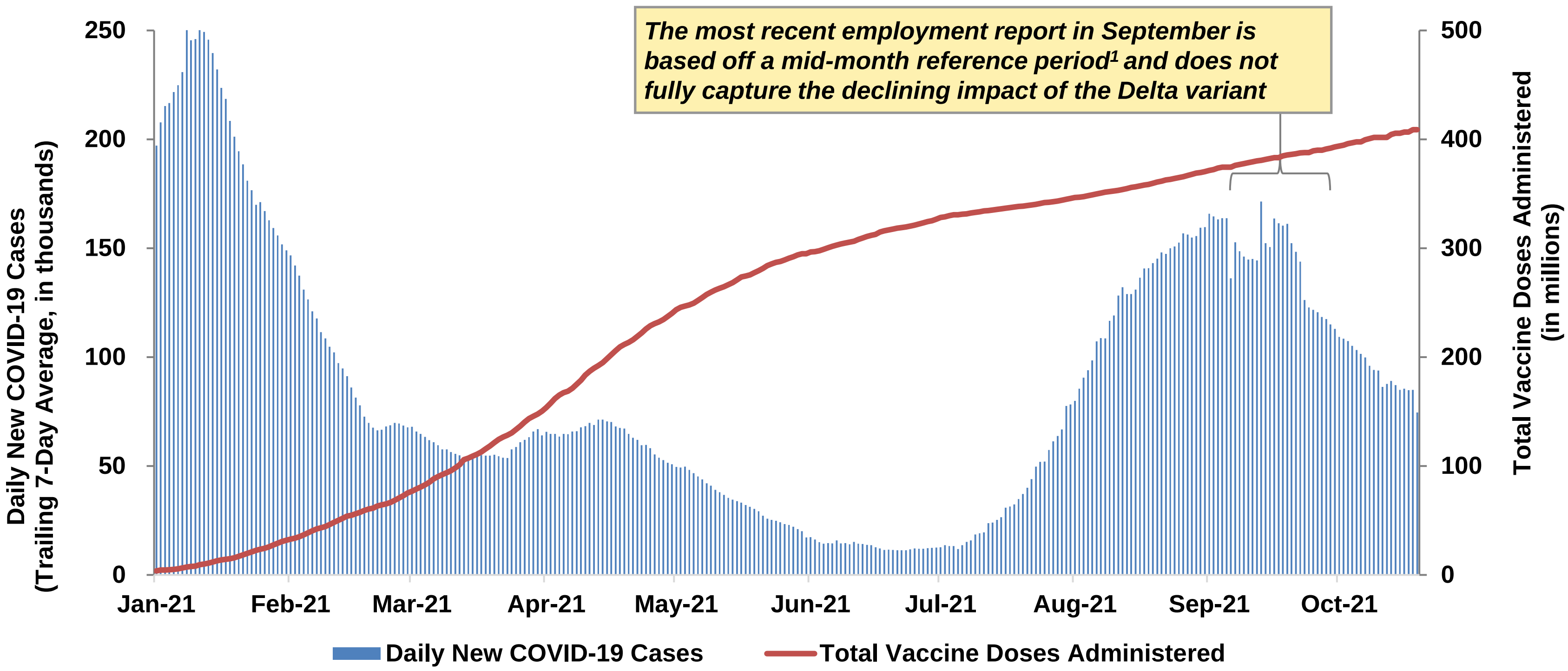


Source: Bureau of Labor Statistics

U.S. COVID-19 Cases and Vaccinations Over Time

As the economy fully emerges from the pandemic and unemployment benefits rollover, we expect the pace of total job additions to meaningfully accelerate in the coming months

Daily New Case Count (Trailing 7-Day Average) and Total Vaccine Doses Administered :



Source: Bloomberg

(1) Employment report reflects data from the Bureau of Labor Statistic's monthly household and establishment survey. In the household survey, the reference period is generally the calendar week that contains the 12th day of the month. In the establishment survey, the reference period is the pay period including the 12th

Mid to High-Single-Digit Annualized Inflation

The annualized pace of growth across several key inflation measures, including wage inflation, has remained elevated in the mid to high-single-digit range, considerably in excess of the Federal Reserve's long-term target of 2%

% Month-over-Month and Annualized Change in Key Inflation Metrics:

	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Average
CPI	**0.8%**	**0.6%**	**0.9%**	**0.5%**	**0.3%**	**0.4%**	**0.6%**
Annualized	***9.6%***	***7.2%***	***10.8%***	***6.0%***	***3.6%***	***4.8%***	***7.2%***
Core CPI	**0.9%**	**0.7%**	**0.9%**	**0.3%**	**0.1%**	**0.2%**	**0.5%**
Annualized	***10.8%***	***8.4%***	***10.8%***	***3.6%***	***1.2%***	***2.4%***	***6.4%***
Core PCE	**0.6%**	**0.6%**	**0.5%**	**0.3%**	**0.3%**	***N.A.***	**0.5%**
Annualized	***7.4%***	***6.8%***	***5.8%***	***3.8%***	***4.0%***	***N.A.***	***5.7%***
Wage Inflation[1]	**0.7%**	**0.5%**	**0.4%**	**0.4%**	**0.4%**	***0.6%***	**0.5%**
Annualized	***8.4%***	***6.0%***	***4.8%***	***4.8%***	***4.8%***	***7.2%***	***6.2%***

Source: Bureau of Labor Statistics

(1) Represents the month over month change in the seasonally adjusted, average hourly earnings of all nonfarm payroll employees as published in the BLS' Employment Situation Report

CPI Inflation by Expenditure Category

Even excluding the impact of new vehicles and used cars and trucks, which have experienced heightened inflation, CPI has been increasing at an annualized growth rate of approximately 5%

CPI Inflation by Expenditure Category:

	Weighting	Trailing 6 Month Average % MoM	Trailing 6 Month Average Annualized	Contribution
CPI - All items	**100%**	**0.6%**	**7.2%**	**7.2%**
Food	14%	0.6%	7.4%	1.0%
Food at home	8%	0.6%	8.1%	0.6%
Food away from home	6%	0.5%	6.8%	0.4%
Energy	7%	1.0%	13.3%	1.0%
Energy commodities (motor fuel)	4%	1.1%	14.5%	0.6%
Energy services (electricity and gas)	3%	0.9%	11.6%	0.4%
Core CPI - All items less food and energy	**79%**	**0.5%**	**6.4%**	**5.0%**
Commodities (ex. food and energy)	21%	1.2%	14.9%	3.1%
New vehicles	4%	1.4%	17.9%	0.7%
Used cars and trucks	3%	4.2%	63.4%	2.2%
Apparel	3%	0.2%	3.0%	0.1%
Medical care commodities	1%	0.1%	1.0%	0.0%
Household furnishings and supplies	4%	0.7%	9.4%	0.3%
Recreation commodities	2%	0.4%	5.3%	0.1%
Other commodities	4%	(0.1%)	(0.9%)	(0.0%)
Services (ex. Energy)	58%	0.3%	3.7%	2.1%
Shelter	33%	0.4%	4.5%	1.5%
Transportation services	5%	0.3%	3.9%	0.2%
Medical care services	7%	0.1%	0.8%	0.1%
Other services	13%	0.2%	3.0%	0.4%
Memo: CPI excluding new vehicles and used cars and trucks			**4.7%**	
Core CPI excluding new vehicles and used cars and trucks			*3.0%*	

Source: Bureau of Labor Statistics

Economic Context of Historical Tightening Cycles

Both the unemployment rate is lower AND inflation measures are substantially higher today than at the beginning of prior rate hike cycles

Summary of Recent Fed Funds Rate Hike Cycles:

	Historical Tightening Cycles						
Date of First Rate Hike	**Apr-87**	**Feb-94**	**Jun-99**	**Jun-04**	**Dec-15**	**Average**	**Current**
Key Economic Indicators at First Rate Hike:[1]							
U-3 Headline Unemployment Rate	**6.3%**	**6.6%**	**4.3%**	**5.6%**	**5.0%**	**5.6%**	**4.8%**
U-6 Unemployment Rate	N.A.	11.4%	7.5%	9.6%	9.9%	9.6%	8.5%
Core CPI Inflation (Trailing 6 Month)	**4.3%**	**2.6%**	**1.4%**	**2.6%**	**2.0%**	**2.6%**	**6.4%**
CPI Inflation (Trailing 6 Month)	*4.7%*	*2.6%*	*2.2%*	*3.7%*	*0.2%*	*2.7%*	*7.2%*
Core PCE Inflation (Trailing 6 Month)	**3.0%**	**1.9%**	**1.1%**	**2.3%**	**1.0%**	**1.9%**	**5.7%**
Total Fed Funds Rate Increase	**3.75%**	**3.00%**	**1.75%**	**4.25%**	**2.25%**	**3.00%**	**?**
Average Rate Increase Per Quarter	0.51%	0.75%	0.48%	0.53%	0.19%	0.49%	?
Starting Fed Funds Upper Bound	**6.00%**	**3.00%**	**4.75%**	**1.00%**	**0.25%**	**3.00%**	**0.25%**

Source: Federal Reserve Board, Bureau of Labor Statistics

(1) Unemployment figures are as of the month of the first Fed Funds rate hike. Inflation figures represent the annualized, average month-over-month increases of the trailing six months prior to the first Fed Funds rate hike.

Bank of England Has Revised its Views on Inflation

The Bank of England recently shifted its perspective to acknowledge the growing need to counteract inflation with tighter monetary policy

Andrew Bailey insists BoE is not 'whistling in the wind' on inflation

Central bank governor uses Mansion House speech to stress that sharp growth in prices is likely to be temporary

""It is important not to overreact to temporarily strong growth and inflation, to ensure that the recovery is not undermined by a premature tightening in monetary conditions," he said.

- Financial Times, July 1, 2021

Bank of England chief warns it 'will have to act' to curb inflation

Andrew Bailey makes no attempt in speech to central bankers to quell expectations of rate rise this year

"The energy story means [the period of high inflation] will last longer," he said.

While he said the BoE could do nothing about the initial price rises in energy and in goods hit by supply chain turmoil, the rate-setting Monetary Policy Committee was increasingly concerned about higher prices raising "medium-term inflation and medium-term inflation expectations".

"That's why we, at the Bank of England, have signalled, and this is another such signal, that we will have to act," Bailey said. "But of course that action comes in our monetary policy meetings," he added.

- Financial Times, October 17, 2021

Commentary from International Monetary Fund

IMF warns on inflation, says the Fed and others should be prepared to tighten policy

Central banks such as the Fed should be preparing to tighten policy in case inflation gets out of control, the IMF warned Tuesday.

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The cautionary tone mentioned the U.S., as well as the U.K. and other developed economies, as places where "inflation risks are skewed to the upside."

"While monetary policy can generally look through transitory increases in inflation, central banks should be prepared to act quickly if the risks of rising inflation expectations become more material in this uncharted recovery," Gita Gopinath, the IMF's economic counselor and director of research, said in an executive summary accompanying the report.

"Central banks should chart contingent actions, announce clear triggers, and act in line with that communication," she added.

………

Though the IMF did not single out the Fed, much of its assessment on inflation indirectly addresses a major policy adjustment the U.S. central bank made in September 2020, when it said it would be willing to allow inflation to run hotter than normal in the interest of generating full and inclusive employment.

That type of policy carries some danger with it if inflation expectations start to surge, the IMF said.

"In settings where inflation is rising amid still-subdued employment rates and risks of expectations de-anchoring are becoming concrete, monetary policy may need to be tightened to get ahead of price pressures, even if that delays the employment recovery," the report said.

Waiting for employment to rebound more strongly "runs the risk that inflation increases in a self-fulfilling way," which then would undermine Fed policy, the IMF said.

- CNBC, October 12, 2021

Risk Factors

- Weakening China growth
- Emergence of new COVID variants
- Second-order impacts from supply chain constraints
- Geopolitical risk
- Cybersecurity risk