Today's Agenda

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Economic Update –This portion of the presentation will cover the U.S. and Global Interest Rate Markets and Catalysts for Change.
Presented By: Christopher Pelletier, Citizens Bank

Economic policy conditions in New Hampshire-
Presented by: Natch Greyes, Government Affairs Counsel, NHMA

Budget specific considerations –
Presented by: Katherine Heck, Government Finance Advisor, NHMA

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GLOBAL MARKETS – FED POLICY AND INTEREST RATE OUTLOOK

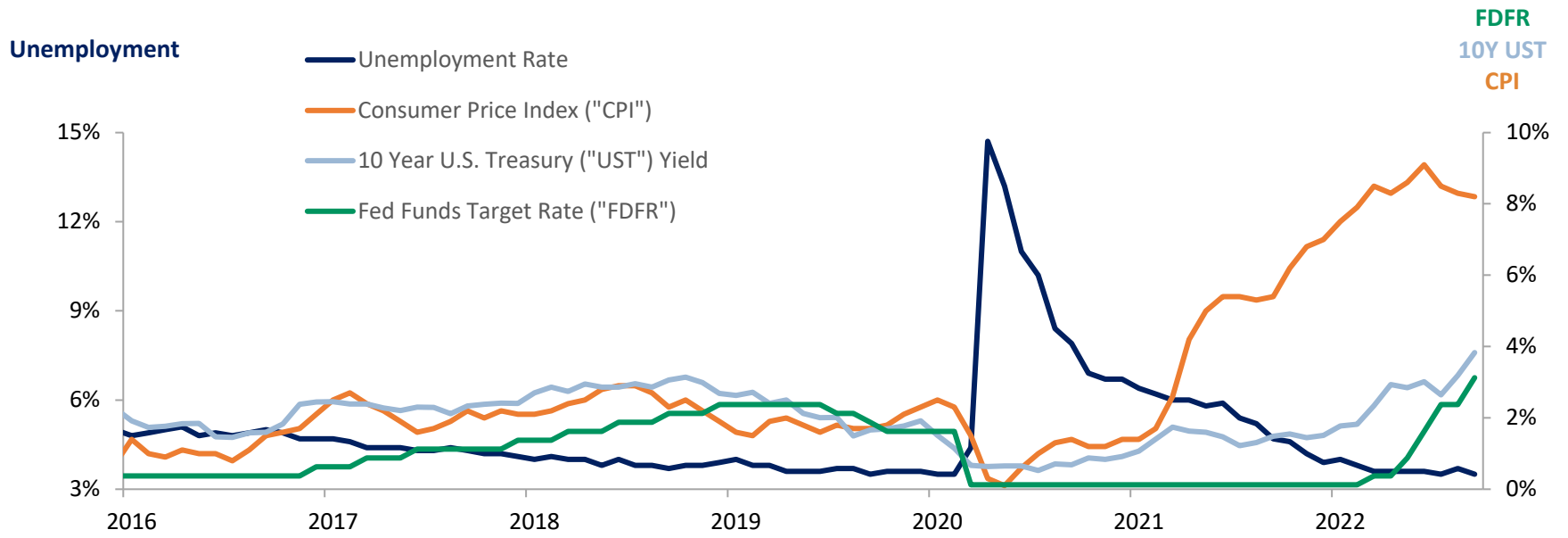
Prepared for NHMA Conference

October 27th, 2022

Market Pre- vs. Post-Pandemic

Economy leading up to the inception of Covid and the aftermath

ECONOMIC BACKDROP



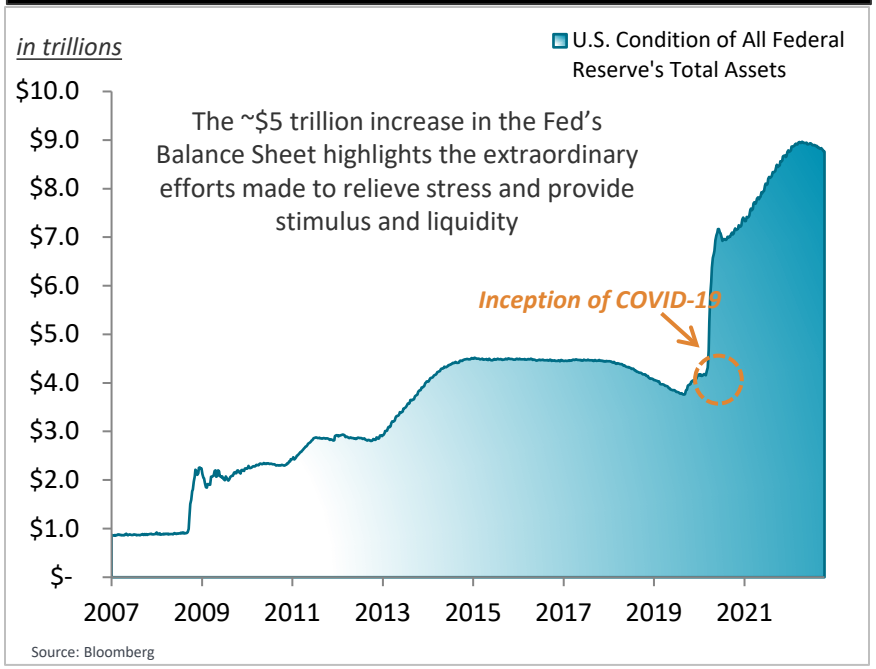
Source: Bloomberg

- Leading into the 2020 Covid-19 crisis, key economic metrics were trading in normalized ranges, with the Unemployment Rate at an all-time low and inflation remaining contained at ~2%
- Covid resulted in the Unemployment Rate spiking to 15% very quickly, however action from Global Central Banks and Governments stabilized the situation fairly quickly
- Implementation of record stimulus resulted in the Unemployment Rate falling back near all-time lows by mid-2022 put upward pressure on wages, however, has left the economy with other issues….

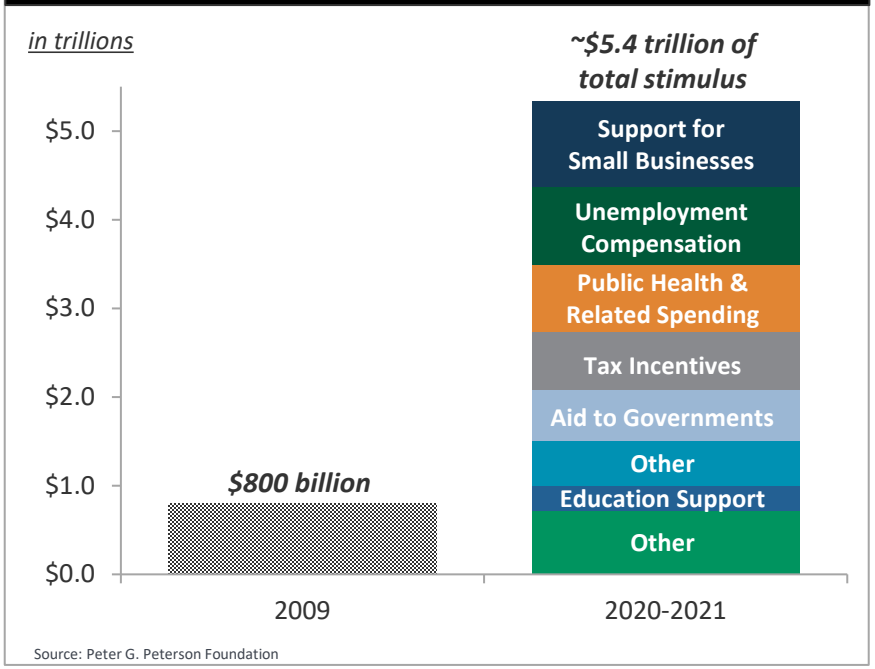
Record Fed Action & Fiscal Stimulus

Federal Reserve balance sheet & congressional accommodation

FEDERAL RESERVE BALANCE SHEET



HISTORIC FISCAL STIMULUS

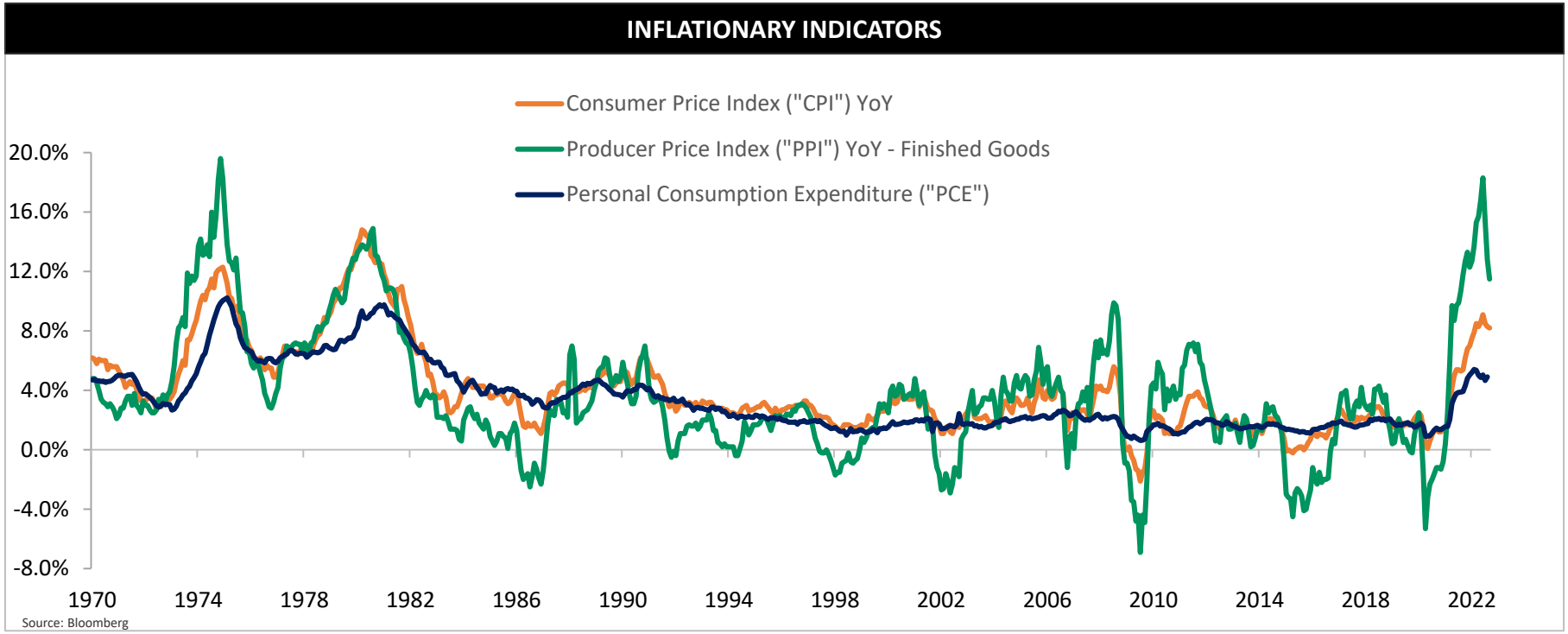


- By increasing the supply of money, the Federal Reserve has effectively provided downward pressure to interest rates
- Just as asset purchases lowered interest rates, the reversal of asset purchases could provide upward pressure to term rates even in the absence of Fed hikes

- Significant cash savings and pent-up demand during the pandemic bolstered the economy once mass vaccination was reached
  - Fiscal stimulus includes the $2 trillion March 2020 Cares Act and the $1.9 trillion March 2021 American Rescue Plan

Inflation

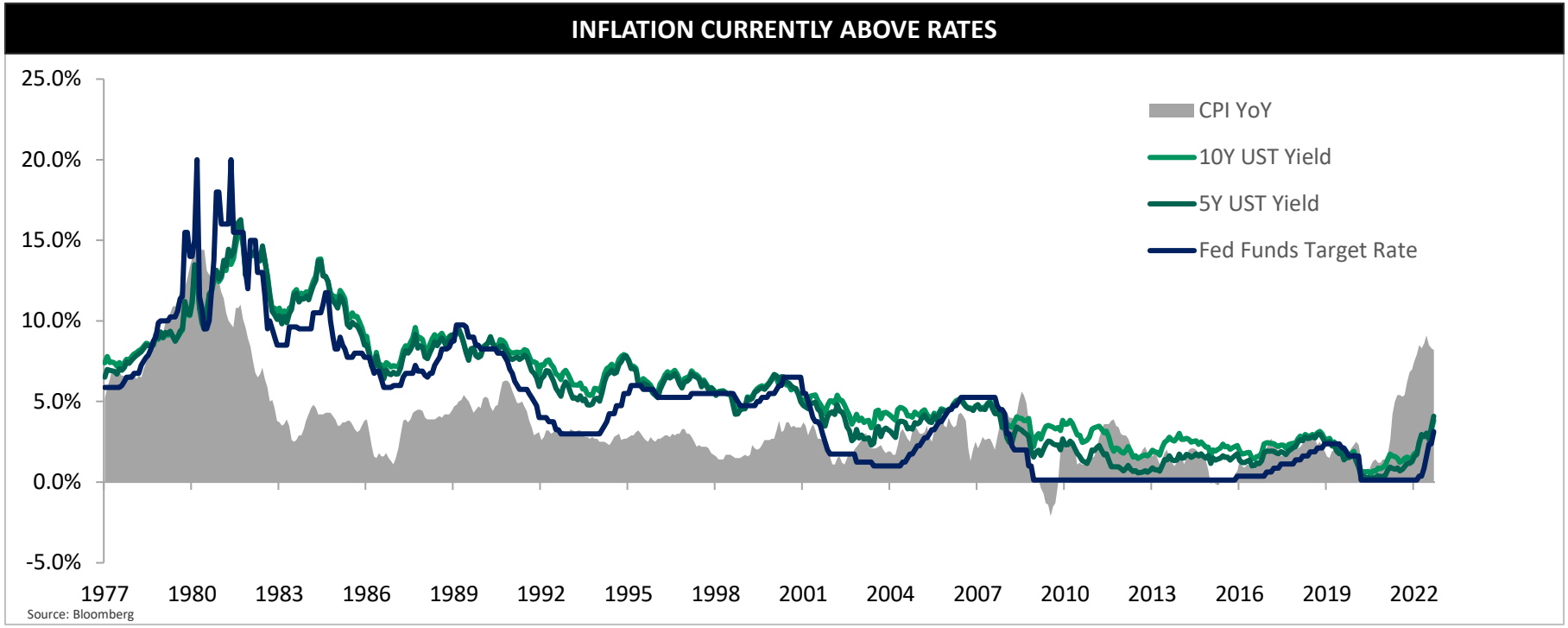
Prices at multi-decade highs



- While various inflation metrics have remained mostly tame for the past few decades, current price pressures stemming from the Covid crisis have not been seen since the early 1980s
- Historically, the Fed and other Central Banks tighten monetary policy in order to stifle inflation. Primarily, the Fed's tools to tighten policy are:
  - Increase short-term borrowing rates (such as the Fed Funds Rate), and…
  - Decrease the size of the Central Bank balance sheet ("Quantitative Tightening")

Yields vs. Inflation vs. Fed Policy

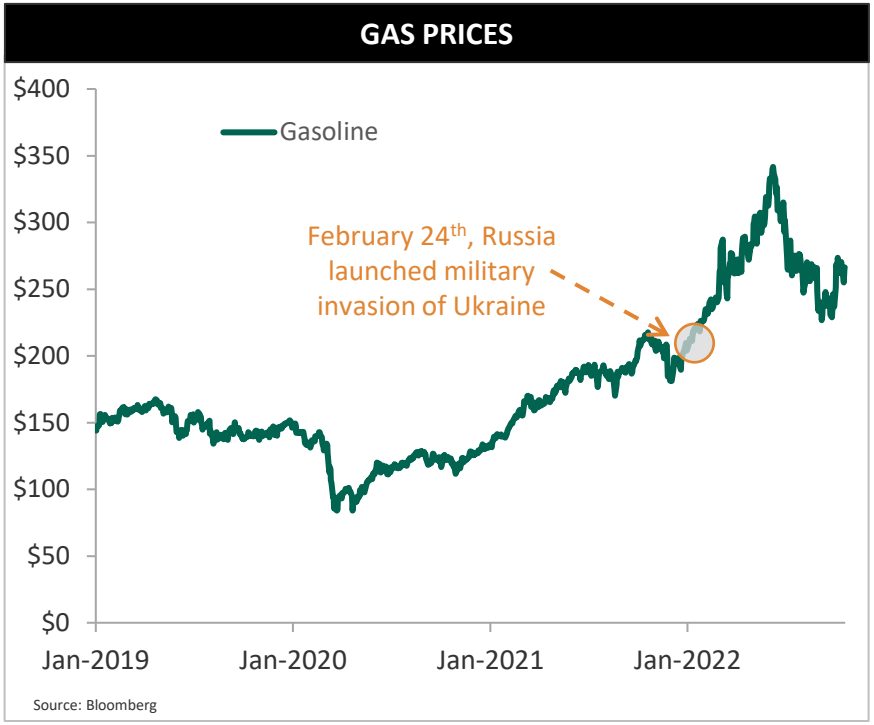
Rates have historically set above inflation to constrain prices

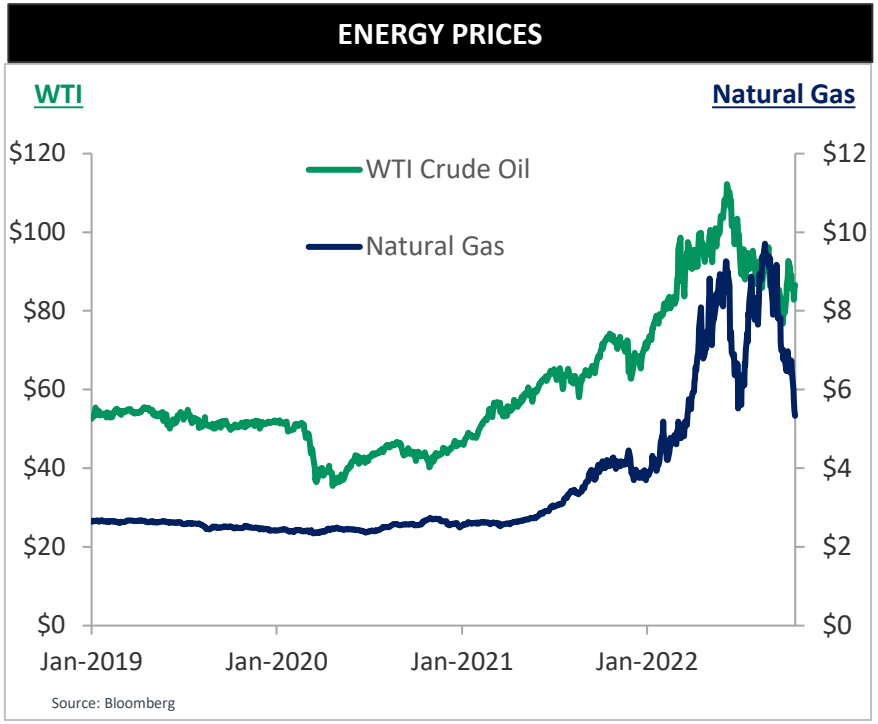


- On past occasions where inflation had risen above palatable levels, Central Banks have tightened monetary policy by increasing their respective short-term borrowing rate (such as the Fed Funds Target Rate in the U.S.)
  - During record inflation in the early 1980s, the Fed pushed short rates as high as 20% to combat record-high inflation (Volcker era)
  - Today we have an economy with primary inflation metrics (such as CPI) well-off 40 year averages, however, interest rates (Fed Funds Target Rate, Treasury yields, etc.) remain well below historical averages

Commodity Prices

Increased costs carving into household balance sheets

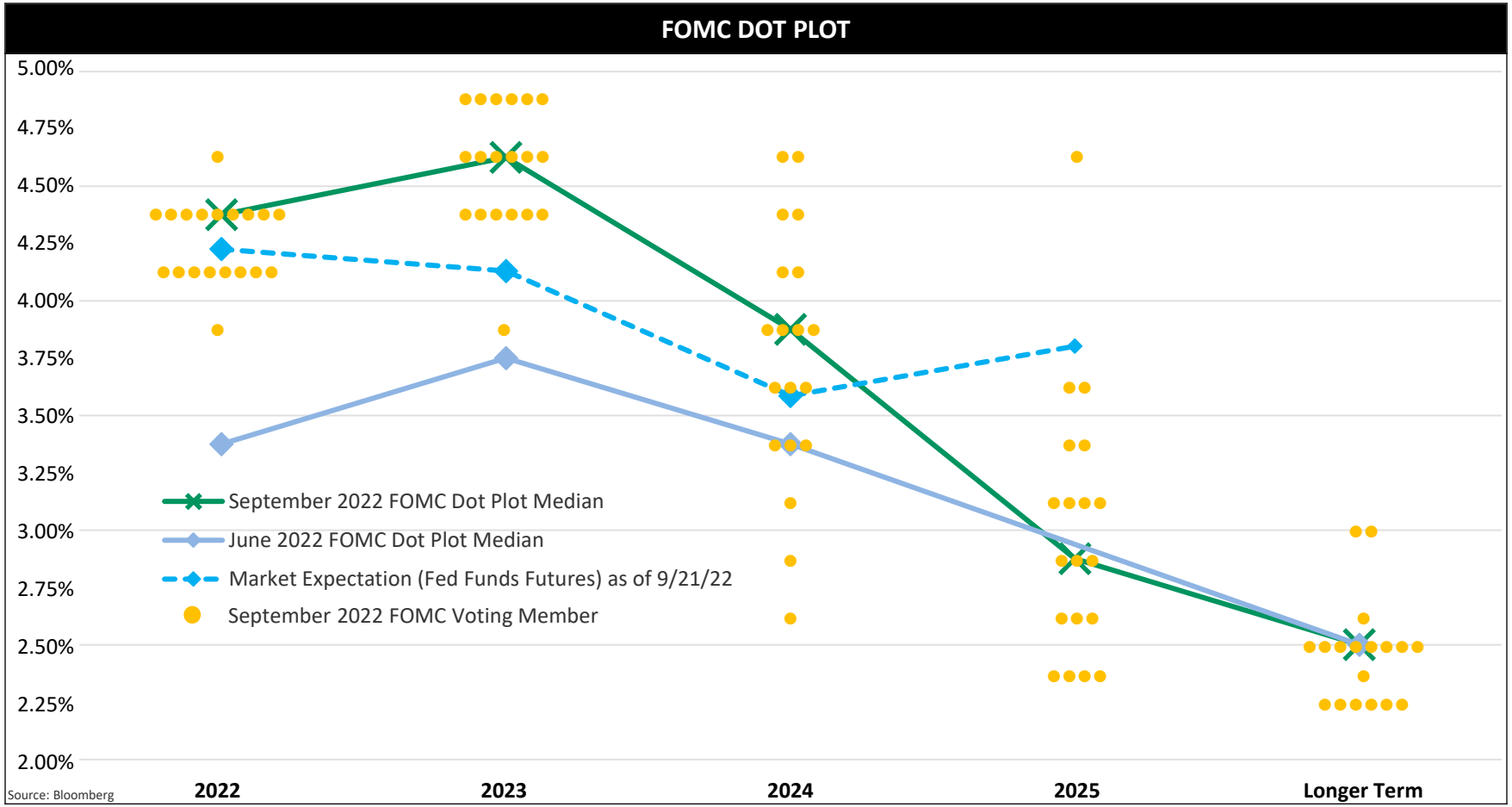




- Energy costs have increased dramatically since spring of 2020; partly as a result of an initial supply chain disruptions coupled with drilling restrictions implemented by the Biden administration, however, the Ukraine – Russia war has further exacerbated the situation
- Higher energy costs have helped fuel inflationary pressures

September 2022 FOMC Dot Plot

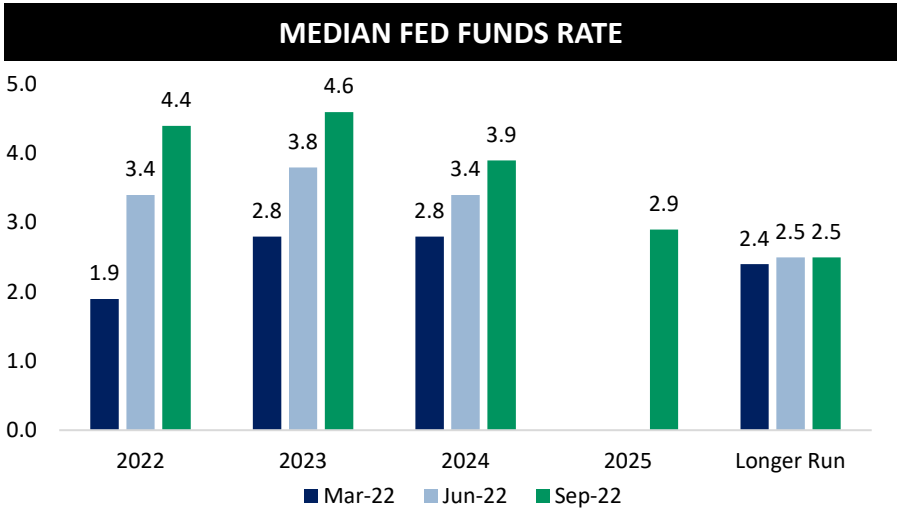
The Fed's tool to communicate its forecasted rate policy



Source: Bloomberg

- The FOMC hiked its policy rate by 75 basis points for the third consecutive at its September meeting, a unanimous decision to bring the target range to 3.00% - 3.25%
- Chair Powell stated, "certainly in my view, and the view of the Committee, there's a ways to go" and they **"will keep at it until the job is done" to bring inflation down to the target level of 2%**
- September's Dot Plot projects another 125 basis points of rate hikes this year and an additional 25 basis points by the end of 2023
  - The median rate is now forecasted to be 4.4% by the end of 2022, up from 3.4% projected in the June dot plot, and peaking in 2023 at 4.6%

The Fed's Summary of Economic Projections



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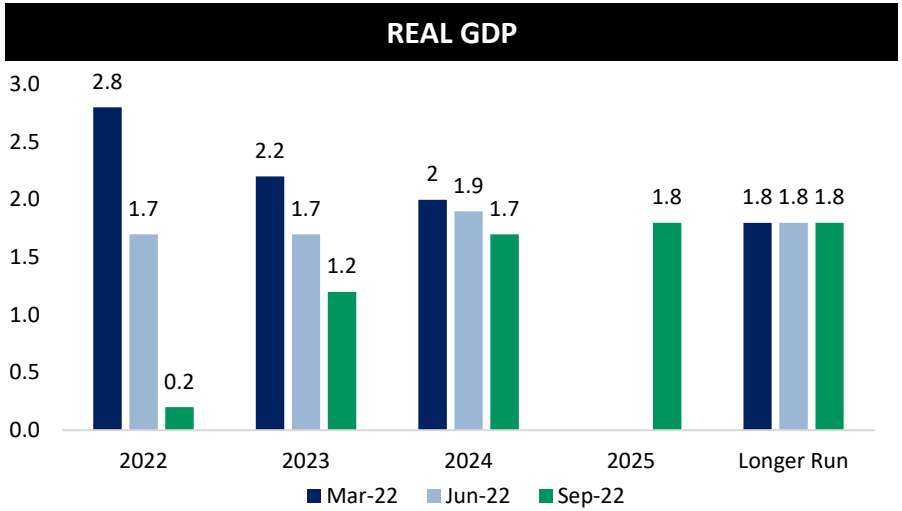

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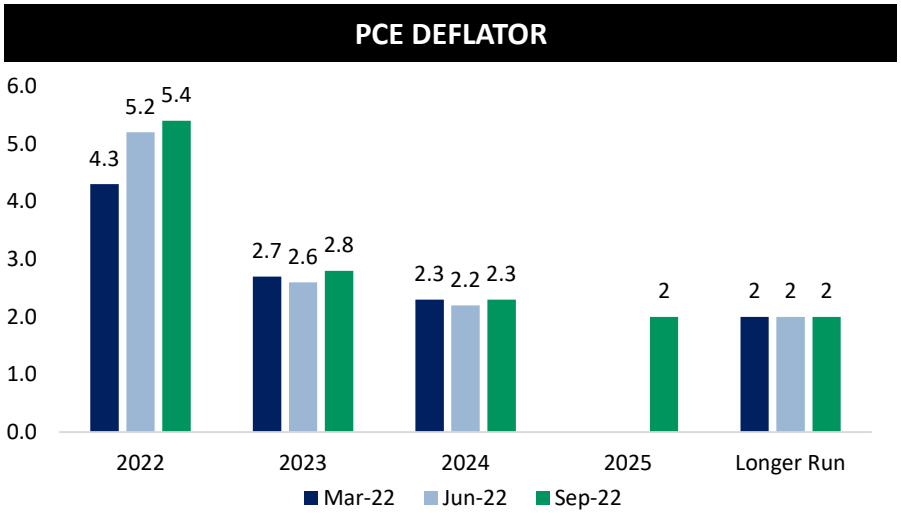

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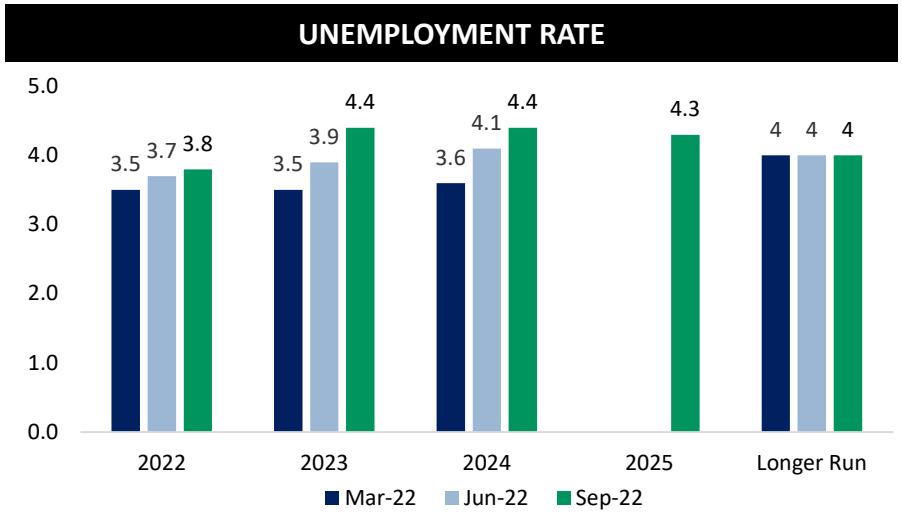
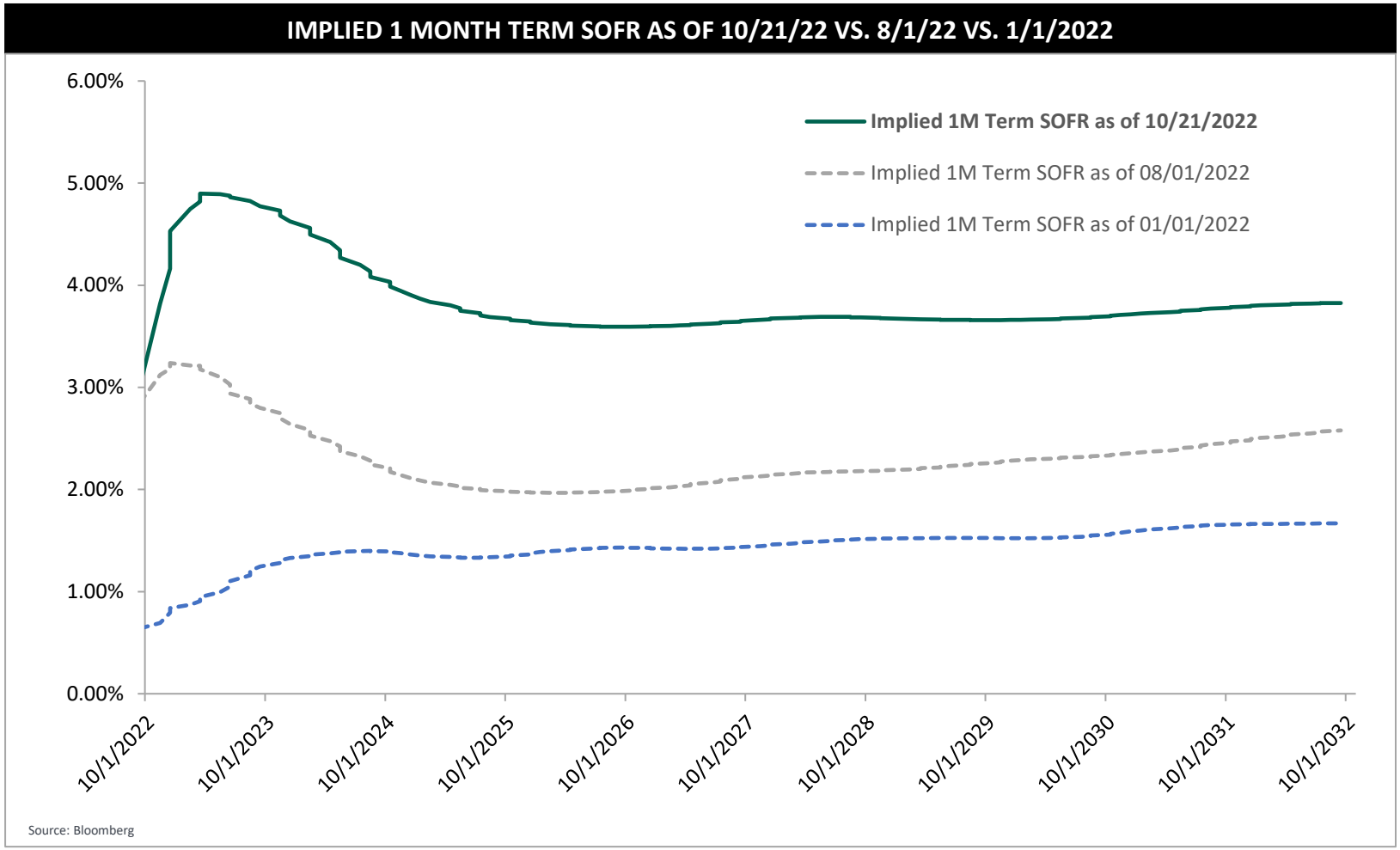
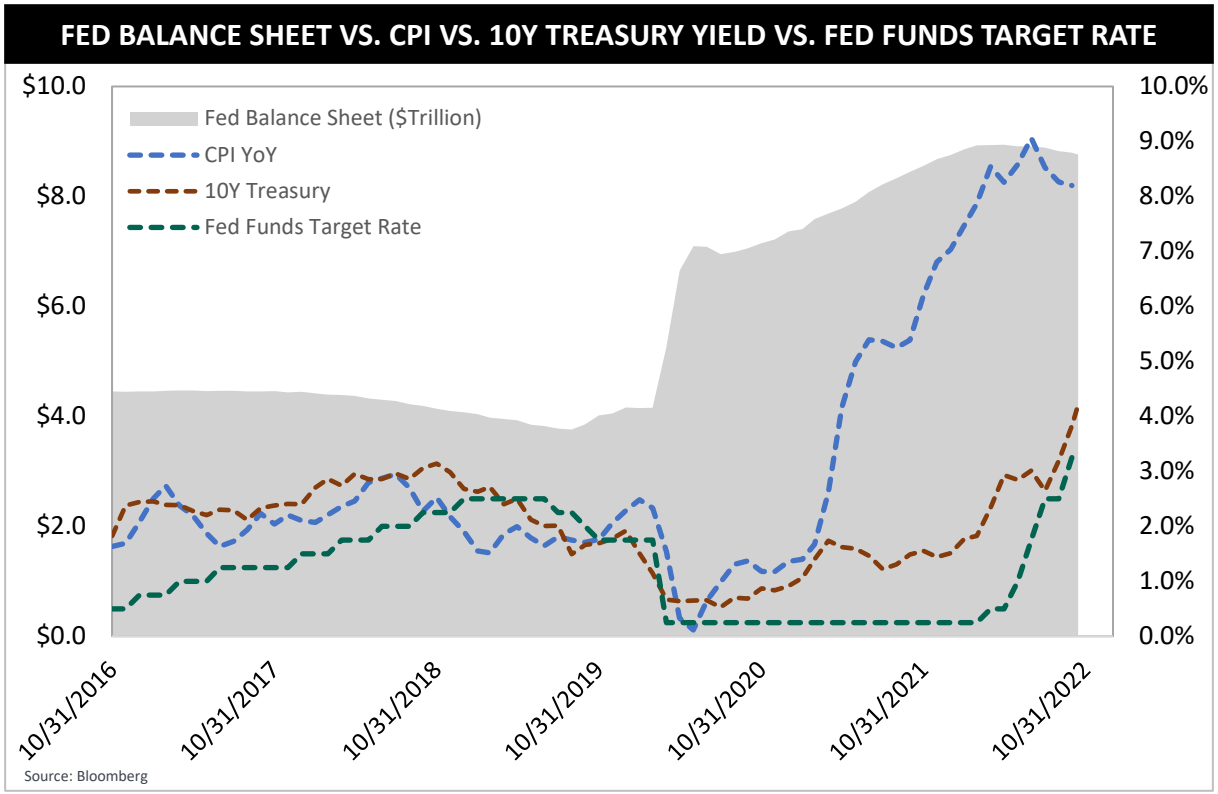


Source: Federal Reserve's Summary of Economic Projections

Implied 1m Term SOFR Curves

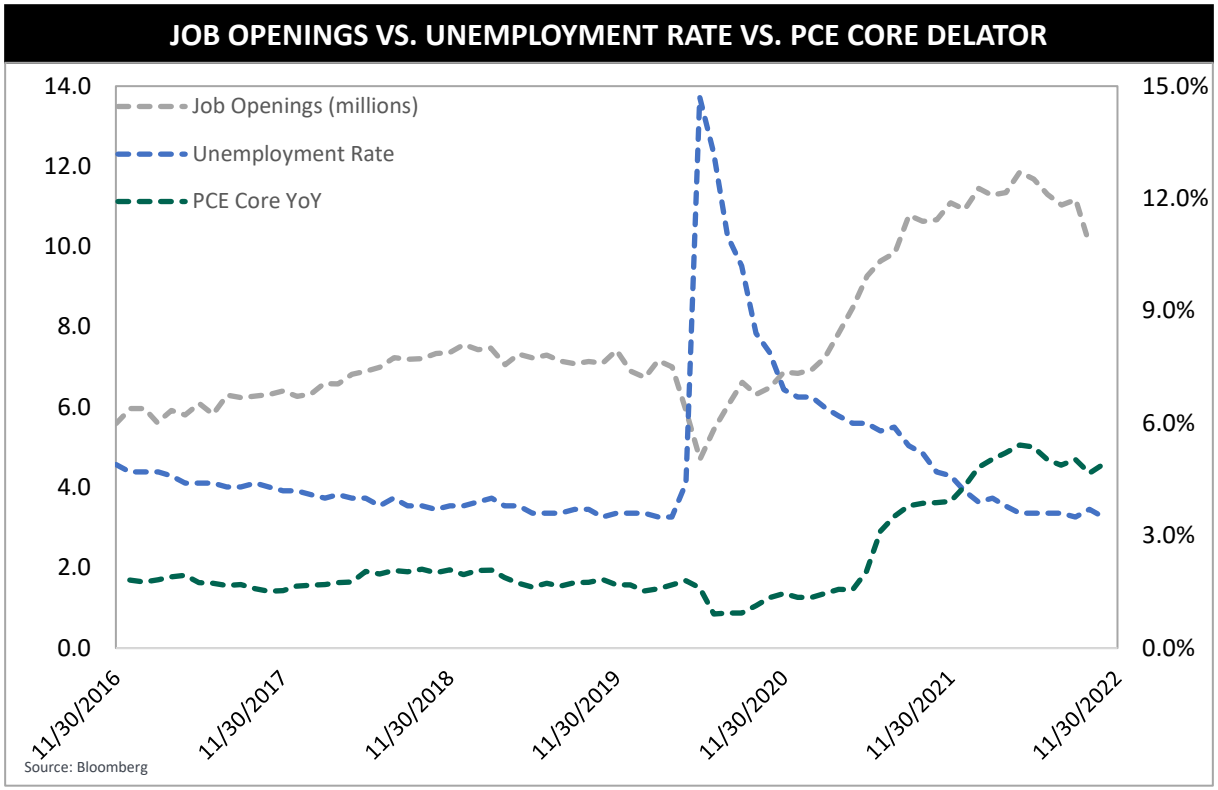


Fed Policy Vs. CPI Data



- Despite 300 basis points of rate hikes YTD and balance sheet roll off of $95B per month, inflation has remained uncomfortably elevated, keeping the FOMC on their policy tightening path
  - Headline consumer prices (CPI) for September reported at 8.2% YoY, decelerating from 8.3% in August, however exceeding estimates of 8.1%
- The 10-year U.S. Treasury yield has continued to climb to levels not seen since 2007, in response to higher-than-expected inflation figures and historically low unemployment
  - The market is pricing in an 81% chance of a 75-bp rate hike at the December meeting

Economic Metrics



- The Fed's top priority is to restore price stability, however there is limited evidence of a near term pivot in policy as employment data prevails persistently
  - The Job Openings and Labor Turnover Survey (JOLTS) reported openings of 10.1 million in August, a 1.1 million decline, though the ratio of jobs for every unemployed person remains well above the Fed's ideal 1-to-1 ratio
  - The Unemployment Rate in September slid to the multi-decade low of 3.5%, demonstrating more resilience in the labor force than the Fed would like to see
  - PCE Core deflator, the Fed's preferred inflation gauge, increased from 4.7% to 4.9% in August, evidence that the Fed's rate hikes thus far are not adequate

Questions?

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