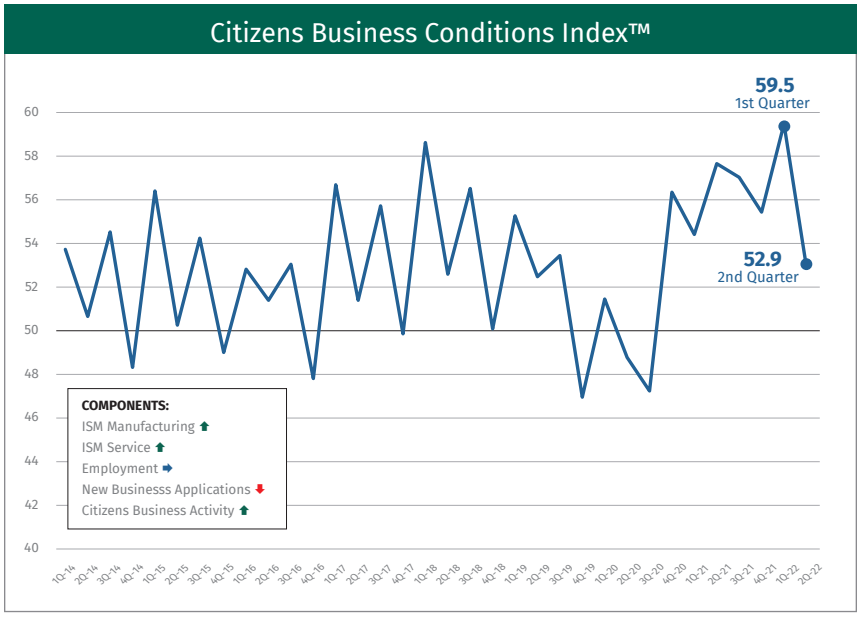
2Q 22 CITIZENS BUSINESS CONDITIONS INDEX™

Business Conditions Down From Peak, But Still Positive

The national Citizens Business Conditions Index™ (CBCI) registered 52.9 in the second quarter, moderating from the peak reading of 59.5 in the first quarter. The index extended its streak to seven straight quarters above 50, indicating continued growth conditions for businesses.

Business activity remains healthy but has clearly cooled from the prior quarter. This could reflect an economy returning to a more sustainable trendline – or it could indicate that conditions are poised to worsen. Consumer inflation continued to trend higher throughout the quarter, reaching an annual pace of 9.1% in the report for June. The Federal Reserve Bank (Fed) hiked interest rates twice, and the Treasury market flashed a recessionary signal as the gap between 2-year and 10-year bond yields fell below zero. Consumer sentiment touched new lows. Yet, spending held steady, as pent-up demand from COVID restrictions continued to drive economic activity.



Source: Citizens

> "We are seeing several cross currents in the environment. Fear levels are high, but individual outlooks are still good. Companies are still experiencing growth and maintaining positive momentum individually, and consumers are showing resilience. We see markets trying to calibrate expectations with these conflicting signals."
>
> - Eric Merlis
> Head of Global Markets

Citizens™

DOWN FROM HIGHS

Three of the five index components were additive in the second quarter – another sign of moderating activity after five out of five were positive in Q1. Both the manufacturing and non-manufacturing indexes from the Institute of Supply Management trended in expansionary territory. However, they also showed moderation from Q1. The manufacturing index peaked around the first quarter of 2021 when the COVID rebound was in full swing. The non-manufacturing index peaked in the fourth quarter of 2021.

We also saw continued strength in the proprietary activity data of our commercial banking clients, another underlying component of the CBCI. On the other hand, applications for new business formation were down in the period, detracting from the CBCI and indicating a pause from Q1.

Meanwhile, employment trends were neutral for the period. This is particularly notable at a moment when growth is slowing and recession fears have increased. After the unexpected GDP contraction in the first quarter, a second-quarter contraction could signal an economic recession, according to the standard definition. A typical recession is accompanied by a weak labor market and higher unemployment – but the scenario could evolve differently in an environment where the job market is already contending with a shortage of labor. If the U.S. experiences a "jobful" slowdown of sorts, consumer activity could remain supported – more so than in a traditional recession.

The moderated pace of business activity could also support the Fed's efforts to contain inflation. Supply-chain backlogs showed signs of easing in the quarter.

COMMODITY-RELATED SECTORS LEAD AGAIN

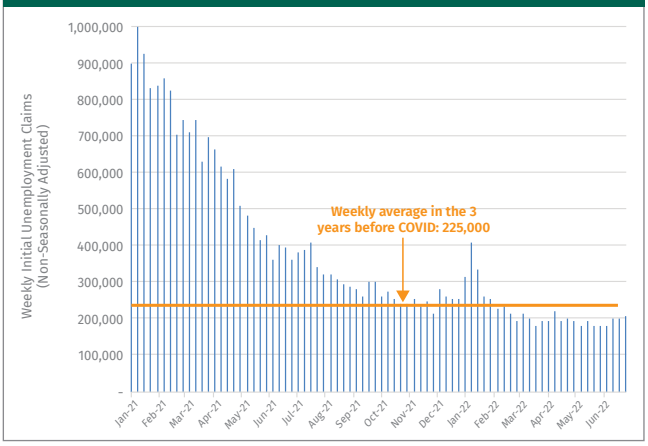
Within our proprietary business-activity data, all sectors moderated from the first quarter but remained in expansionary zones. Basic materials and energy companies led performance as commodity-price gains persisted through the period. The Russian war on Ukraine continued to affect supply across commodities, including energy, food and metals/minerals. Energy pricing also delivers a "spillover" effect to other commodities, as it is an input for production and transport. Financials, government entities and technology-sector companies posted the lowest levels of growth comparatively, but still registered positive conditions.

Geographically, we saw a reversal from Q1 trends, with companies in the Midwest showing the lowest levels of activity for the quarter in our proprietary business-activity data. Companies in the Mid-Atlantic region showed the highest levels of growth, while companies in the Northeast landed in the middle.

A TRANSITION UNDERWAY

The second-quarter CBCI reading reflected a business environment where activity is still expansionary but reduced from a recent peak. The continued climb in inflation could prove to be a lagging indicator from the impact of that first-quarter peak activity. There were markers in the second quarter that businesses encountered more sustainable conditions. Recessionary signals from the bond market indicate more headwinds ahead, but the employment landscape could prove supportive.

Sturdy Job Market Fueled Activity



Source: U.S. Department of Labor

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