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Monday Economic Report

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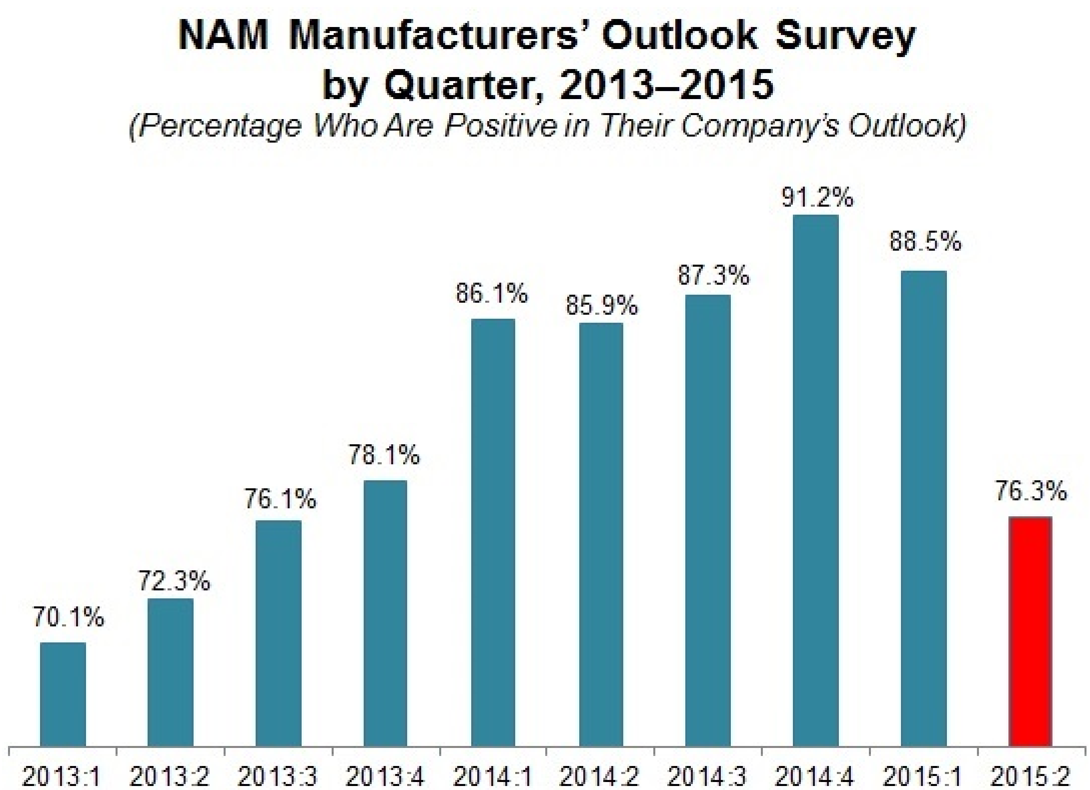

Manufacturers and other businesses came into this year with a lot of optimism, particularly given robust growth in the second half of last year. Instead, economic growth has been disappointing year-to-date. A number of significant headwinds have challenged the sector, including a stronger dollar, lower crude oil prices, the residual effects of the West Coast ports slowdown and cautiousness in consumer spending. Much of this can be seen in recent GDP and production figures, which have reflected recent declines in activity, particularly in the first quarter.

As a result, market participants have downgraded their growth estimates for this year. Business economists responding to the National Association for Business Economics (NABE) Outlook Survey now expect real GDP growth of 2.4 percent for 2015, down from 3.1 percent just three months ago. Panelists also anticipate industrial production expanding more slowly, down from 3.7 percent in the March survey to 2.3 percent now. The Manufacturers Alliance for Productivity and Innovation (MAPI) forecast calls for a similar reduction in manufacturing output, with 2.5 percent growth this year. On the positive side, MAPI anticipates 4.0 percent growth in manufacturing production in 2016, suggesting a possible rebound.

These reports mirror the latest NAM Manufacturers' Outlook Survey, which found that business leaders were less upbeat today than six months ago. The percentage of respondents who were positive about their own company's outlook has dropped from 91.2 percent in December to 76.3 percent today, a significant decline in such a short period of time, reflecting the challenges noted above. Likewise, the newly created NAM Manufacturing Outlook Index has fallen from 61.7 to 51.7 over that same time frame. This indicates that manufacturers continue to have above-average assessments about growth, but with some definite deterioration in sentiment. Indeed, growth estimates for sales, capital spending and hiring have slipped significantly since the last survey. For instance, manufacturers predict sales growth of 2.7 percent over the next 12 months, down from the 4.3 percent estimate in March. At the same time, exports are anticipated to grow by just 0.4 percent over the next year, indicating continued sluggishness in light of currency concerns and softer growth abroad.

Meanwhile, there were also some encouraging surveys last week that we hope show the beginning of a rebound in sentiment. First, the National Federation of Independent Business (NFIB) reported that optimism rose for the second straight month, with its headline index up from 96.9 in April to 98.3 in May. This was the highest level so far in 2015, with better news on sales, hiring and a desire to expand. In a similar way, consumer confidence picked up again in preliminary data from the University of Michigan and Thomson Reuters. The Consumer Sentiment Index increased from 90.7 in May to 94.6 in June, and while it remains below the 11-year peak in January (98.1), Americans were more upbeat in their assessments of the current and future economic climate. Retail sales were also stronger in the latest release, up 1.2 percent in May, bouncing back from a softer April.

Next week, there will be a number of indicators released showing the current health of the U.S. manufacturing sector, including industrial production and surveys from the New York and Philadelphia Federal Reserve Banks. After several months of softness, we will be looking for signs of a rebound in manufacturing activity in these latest reports. Similarly, the latest housing starts figures will be examined to see if the stronger growth observed in April can be sustained in the May release.

The highlight of the week will come on Wednesday, with the announcement from the Federal Reserve of its monetary policy moves. At one time, it was thought that short-term rates might start to increase at the June meeting, but conventional wisdom now holds that the normalization of rates will begin this fall instead. The latest producer price index report continues to show minimal inflationary pressures overall, freeing the Federal Reserve's hand to stimulate growth, at least for now. Core inflation has risen just 0.6 percent over the past 12 months, remaining below the Federal Reserve's threshold of 2 percent for 24 straight months. Other indicators to watch next week include new data on consumer prices, leading indicators and state employment.

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Last Week's Indicators:
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Friday, June 19
State Employment Report

Summaries for Last Week`s Economic Indicators

Job Openings and Labor Turnover Survey

The Bureau of Labor Statistics reported that net hiring in the manufacturing sector remained negative for the third consecutive month. The Job Openings and Labor Turnover Survey (JOLTS) release continued to show softer-than-desired employment activity for the manufacturing sector in April, mirroring headwinds seen in other economic indicators. Manufacturers hired 256,000 workers in April, down slightly from 257,000 in March. At the same time, total separations—including layoffs, quits and retirements—fell from 264,000 to 259,000. As such, net hiring (or hires minus separations) was -3,000 in April, or somewhat better than the -7,000 observed in March. We hope to see a rebound in net employment growth in the coming months.

Meanwhile, job openings in the sector also edged lower for the month, down from 333,000 in March to 327,000 in April. Durable (down from 211,000 to 209,000) and nondurable (down from 122,000 to 119,000) goods firms both reported slightly fewer job postings in April. The good news, however, is that the number of job openings has exceeded 300,000 for six straight months, averaging 325,000 from November through April. That represents progress from the 290,000 average for 2014 as a whole, and it could indicate a rebound in hiring moving forward.

In the larger economy, nonfarm job openings increased from 5,109,000 to 5,376,000, a new all-time high for the data series that began in December 2000. The higher figure was boosted by increased postings for accommodation and food services, education and health services, government, professional and business services and retail trade. At the same time, net hiring was just 126,000 for the nonfarm sector in April, which was weaker than we would prefer. Still, we know from the latest overall jobs report that May hiring picked up, with 280,000 nonfarm payroll workers added in the month. May JOLTS data will be released on July 7.

MAPI Industrial Outlook

MAPI released its latest industrial outlook, with production expected to grow at a slower pace this year than in earlier forecasts. MAPI now predicts manufacturing output growth of 2.5 percent this year, down from a 3.7 percent forecast three months ago. This finding reflects recent headwinds in the manufacturing sector, including declines in real GDP and manufacturing production in the first quarter. Breaking this down somewhat, computer and electronic products output is expected to increase by 4.7 percent this year, with production from non-high-tech manufacturers up 2.4 percent.

On the positive side, economic activity is expected to rebound moving forward. MAPI estimates that manufacturing output will increase by 4.0 percent and 3.1 percent in 2016 and 2017, respectively. Looking at other economic variables, housing starts are also anticipated to accelerate, up to 1.30 million units by 2016 and 1.46 million units by 2017. Regarding auto production, the outlook for auto and light truck sales is 16.9 million units in 2015, 17.4 million units in 2016 and 17.9 million units in 2017.

NABE Outlook Survey

Panelists responding to the NABE Outlook Survey downgraded their estimates for growth in 2015. Business economists now expect real GDP growth of 2.4 percent this year, down from 3.1 percent in the March survey. This reflects recent headwinds in the U.S. economy, with 80 percent and 72 percent suggesting that a stronger U.S. dollar and slower growth in China, respectively, were having a negative impact on U.S. economic growth. To illustrate this point, the estimates for export growth have declined from 5.4 percent in December to 2.1 percent in the current report.

Moreover, economists expect industrial production to expand more slowly, down from a forecast of 3.7 percent in the March survey to 2.3 percent now. The good news is that this is anticipated to rebound to 3.0 percent growth in 2016, mirroring the outlook for 2.9 percent real GDP growth next year. Americans are seen purchasing 16.8 million light vehicles in 2015 and 17.0 million units in 2016, with housing starts rising from 1.10 million to 1.28 million in 2015 and 2016, respectively. In terms of the labor market, nonfarm payrolls are predicted to grow by 217,000 each month this year.

Looking at monetary policy, 74 percent of business economists expect the Federal Reserve to begin raising short-term rates in the third quarter. *(Note that I am one of the panelists on this survey.)*

NAM Manufacturers' Outlook Survey

Manufacturers were less upbeat in the latest NAM Manufacturers' Outlook Survey, with 76.3 percent positive about their own company's outlook. This dropped from 88.5 percent in March and corresponds with a decline in the newly created NAM Manufacturing Outlook Index from 59.9 three months ago to 51.7 today. Index readings greater than 50 suggest that manufacturing respondents have above-average assessments in their current outlook, coinciding with an expanding sector. As such, the manufacturing economy appears to be growing, but at a much slower pace than in past surveys.

Indeed, measures for various types of activity mirrored this result. Manufacturers expect sales to grow 2.7 percent over the next 12 months, down from 4.3 percent in the last survey. Capital spending (down from 2.3 percent to 1.9 percent), hiring (down from 1.9 percent to 0.8 percent) and exports (down from 0.9 percent to 0.4 percent) followed suit, with decelerating paces of growth anticipated moving forward. Regarding exports, sluggish growth in the months ahead likely stem from headwinds in currency markets and with slowing economies in key export markets. This perhaps explains why the outlook index is lower for large manufacturers (49.8) than for smaller ones (55.0).

Manufacturing leaders continue to be frustrated with Washington. The top business challenges in this survey were the business climate (76.3 percent) and rising health care costs (74.1 percent). On this latter point, manufacturers expect health insurance costs to rise 7.9 percent on average over the next 12 months. In addition, they seek comprehensive tax reform and ways to reduce the overall regulatory burden.

Along those lines, two-thirds of respondents expressed concern about proposed ozone regulations from the Environmental Protection Agency, with nearly 80 percent suggesting they would either not continue or were uncertain whether they would proceed with new construction or modifications if their local area was out of compliance. Meanwhile, a whopping 95.5 percent of those completing the survey said it was important for policymakers to address the nation's fiscal challenges.

NFIB Small Business Survey

The NFIB reported that optimism rose for the second straight month. The Small Business Optimism Index increased from 96.9 in April to 98.3 in May, its highest level so far in 2015. This suggests that small business owners have begun to move beyond the recent lull in confidence. Still, it remained below the peak observed in December (100.4), which marked its highest level since October 2006. Indeed, this report continues to reflect lingering anxieties about the economy, even as owners indicate they are more upbeat today than they have been in past years.

The good news is many of the key indicators moved in the right direction in May. The percentage of respondents suggesting that now is a "good time to expand" increased from 10 percent to 14 percent, and sales grew a net 7 percent for the month, ending a four-month negative sales streak. In addition, the net percentage planning to hire over the next three months edged higher, up from 11 percent to 12 percent.

To be fair, many of these data points remain lower than in December, and some areas pulled back a little. For instance, the percentage planning for capital expenditures over the next three to six months declined slightly from 26 percent to 25 percent, and the net percentage expecting sales to increase over the next three months dropped from 10 percent to 7 percent, its lowest level since November 2013. This latter point gives us a little pause in an otherwise mostly positive report, as it suggests some caution moving forward.

Respondents equally chose taxes and regulatory burdens as the top "single most important problem," with each cited by 23 percent of those taking the survey. These were followed by the quality of labor (13 percent) and poor sales (11 percent).

Producer Price Index

The Bureau of Labor Statistics reported that producer prices for final demand goods and services increased 0.5 percent in May, rebounding from the 0.4 percent decline in April. Moreover, producer prices for final demand goods jumped 1.3 percent, led by increased costs for foods (up 0.8 percent) and energy (up 5.9 percent). Indeed, the price of West Texas Intermediate crude oil rose from an average of $54.27 per barrel in April to $59.27 in May, helping to explain the additional cost for energy. Still, even with the increase in May, energy costs have declined 19.3 percent year-over-year, continuing to reflect the sharp decline in crude oil prices from earlier heights.

Food prices at the producer level were higher in May, including for eggs, fish, fruits and vegetables, pork and turkeys. The cost of eggs, in particular, soared 42.9 percent for the month on avian flu challenges. Yet, producers have largely benefited from lower food costs year-to-date—a trend that continued even with May's increases. Producer prices for final demand food goods have fallen 3.4 percent since December.

Excluding food and energy, core producer prices for final demand goods increased 0.2 percent in May. Some notable price increases for the month included cleaning and polishing products, light motor trucks, oil-field machinery and pharmaceuticals. In contrast, there were decreases in the costs for industrial chemicals, metal-cutting machine tools, metal-forming machine tools and railroad equipment, among others.

The bottom line is that inflationary pressures remain minimal right now. Producer prices for final demand goods and services have declined year-over-year for five straight months, down 1.0 percent. That was a slight improvement from the 1.3 percent year-over-year decrease in April. Meanwhile, core inflation—which excludes food and energy costs—has risen 0.6 percent over the past 12 months, down from a 0.7 percent gain the month before. Core input prices have remained below the Federal Reserve's threshold of 2 percent for 24 straight months. This allows the Federal Open Market Committee to continue its accommodative measures to stimulate the economy.

Retail Sales

According to the Census Bureau, retail sales increased 1.2 percent in May, bouncing back from a softer April, where spending rose just 0.2 percent. On a year-over-year basis, consumers spent 2.7 percent more today than 12 months ago, a modest gain that represents a notable improvement from the 1.5 percent pace in the prior report. Still, the data continue to reflect the softer economic environment seen so far in 2015, with the year-over-year pace down from 4.7 percent in November.

With that said, changes in gasoline prices over the past year have skewed the data. Lower prices have resulted in declining sales, which are expressed in nominal terms, of 18.6 percent since May 2014. Retail spending excluding gasoline station sales climbed 5.2 percent year-over-year in May, up from 4.3 percent in April. This suggests a stronger pace of overall consumer spending than the headline figure might indicate.

It also reflects higher gasoline prices of late, with gasoline station sales up 3.7 percent in May. Indeed, the average price of regular conventional gasoline was $2.656 per gallon on June 1, up from $2.451 a gallon on April 27, according to the Energy Information Administration. Other areas with strong growth in May included building materials and supplies (up 2.1 percent), motor vehicles and parts (up 2.0 percent), clothing and accessories (up 1.5 percent) and nonstore retailers (up 1.4 percent). The only category to experience declining sales for the month was health and personal care stores, with spending down 0.3 percent.

Over the past 12 months, retail sales grew the fastest for the following types of businesses: food services and drinking places (up 8.2 percent), motor vehicle and parts (up 8.2 percent), sporting goods and hobbies (up 8.0 percent), nonstore retailers (up 7.8 percent), building materials and supplies (up 6.2 percent) and furniture and home furnishings (up 6.2 percent).

University of Michigan Consumer Sentiment

Consumer confidence picked up again in June, according to preliminary data from the University of Michigan and Thomson Reuters. The Consumer Sentiment Index increased from 90.7 in May to 94.6 in June. This figure has been quite volatile year-to-date, beginning the year at 98.1 in January—an 11-year high—before falling to May's low point. Americans have reacted to softer-than-desired economic news in the early months of this year, with persistent anxieties about labor and income growth. Nonetheless, the data also continue to show progress in terms of overall confidence, with the headline index up from 82.5 in June 2014.

Looking more closely at the June data, the public was more upbeat in their views of both the current (up from 100.8 to 106.8) and expected (up from 84.2 to 86.8) economic climate. Final data will be released on June 26, with similar data from the Conference Board out on June 30.

Questions or comments?

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