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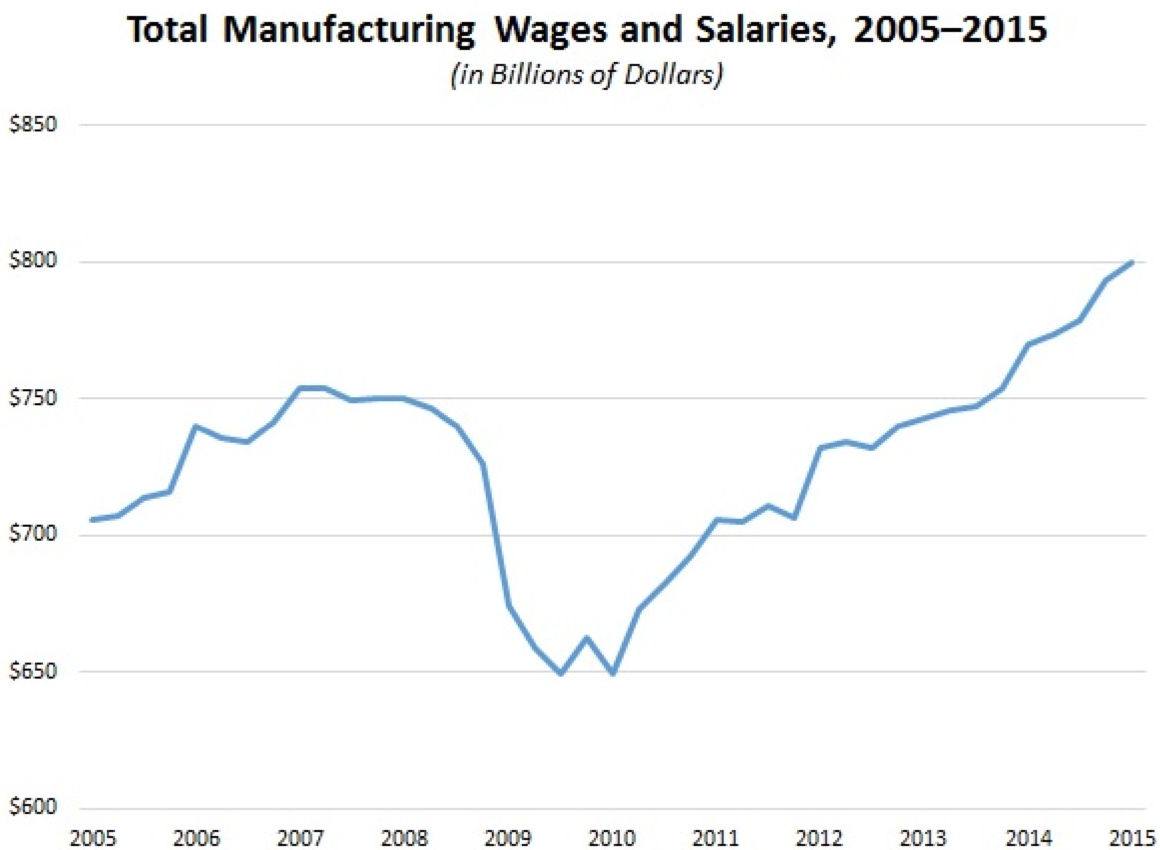

Last week, there were several reminders that the manufacturing sector has not recovered fully from economic weaknesses earlier in the year, even as business leaders remain cautiously optimistic about activity in the coming months. Durable goods orders declined 1.8 percent in May, extending April's 1.5 percent decrease. Much of this softness stemmed from reduced aircraft sales, with orders excluding transportation modestly higher. Nonetheless, durable goods demand has been quite weak for much of the past year. On the positive side, we would expect stronger durable goods orders in the June data, with the recent Paris Air Show lifting aircraft sales, and the broader measure, which excludes transportation, has edged marginally higher over the past three months. We hope that this is the start of a rebound.

Other measures of manufacturing activity were mixed. The Markit Flash U.S. Manufacturing PMI grew at its slowest pace since October 2013, decelerating for the third consecutive month. Sales and output continued to expand modestly, however, and hiring growth accelerated to a seven-month high. Meanwhile, the Richmond Federal Reserve Bank's monthly survey found that new orders grew at their fastest pace since October, a sign that the sector has made progress since the spring. Shipments also stabilized after contracting for four straight months. In contrast, the Kansas City Federal Reserve reported continued declining levels of demand, production and hiring in June, with lower crude oil prices and the stronger dollar challenging the district, which includes energy-intensive areas in Colorado and Oklahoma, among other states. Nonetheless, manufacturers in both regional districts were cautiously positive in their outlook for the next six months, particularly in the Richmond survey.

Looking abroad, the fundamentals in Europe's economy have improved a bit, even as debt uncertainties in Greece continue to haunt the markets. Manufacturing activity in the Eurozone grew at the fastest pace since April 2014, boosted by better production and employment growth. Meanwhile, Chinese and Japanese manufacturers reported contracting activity in June, but with mixed levels of progress. The HSBC Flash China Manufacturing PMI increased to its highest level in three months, even as it has contracted in six of the past seven months. On the positive side, new orders shifted to a slight expansion. The Chinese economy continues to decelerate, but recent indicators suggest that at least some of this softness might have begun to stabilize. At the same time, Japan's economy has been somewhat volatile this year, with its PMI data up one month and down the next. Reduced new orders pushed the Markit Flash Japan Manufacturing PMI just barely into contraction territory in June.

Meanwhile, the Bureau of Economic Analysis reported that the U.S. economy shrank by 0.2 percent in the first quarter, an improvement of sorts from the 0.7 percent decline estimated earlier. The largest drag on real GDP growth in the first quarter continued to be net exports, which subtracted 1.9 percentage points from the headline number. Consumer and business spending also showed weakness. The good news is that we have started to see some rebounds, which should bode well for second quarter growth. (I forecast 2.8 percent real GDP growth for the second quarter.) Personal spending rose 0.9 percent in May, its fastest monthly pace since August 2009 and we hope a sign that Americans are once again starting to open their wallets. Consumer confidence also picked up in its latest release. At the same time, existing and new home sales both increased strongly in May, recovering from softer numbers earlier in the year.

We will continue to look for rebounds in manufacturing activity in a number of indicators this week, including the new Dallas Federal Reserve survey later this morning, the latest Institute for Supply Management Purchasing Managers' Index report on Wednesday and factory orders on Thursday. The other big economic news of the week will be June jobs numbers, which will have a rare Thursday release instead of Friday (due to the upcoming Independence Day holiday). New figures on consumer confidence and construction spending are other economic highlights to watch this week.

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Economic Indicators

Last Week's Indicators:
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This Week's Indicators:

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Monday, June 29
Dallas Fed Manufacturing Survey

Tuesday, June 30
Conference Board Consumer Confidence

Wednesday, July 1
ADP National Employment Report
California Manufacturing Survey
Construction Spending
ISM Purchasing Managers' Index

Thursday, July 2
BLS National Employment Report
Factory Orders and Shipments

Friday, July 3
None

Summaries for Last Week`s Economic Indicators

Chicago Fed National Activity Index

The Chicago Federal Reserve Bank reported that the U.S. economy has operated below its historical trend for five consecutive months. The National Activity Index (NAI) has been negative in each month so far in 2015, edging slightly higher from -0.19 in April to -0.17 in May. Declines in industrial production did not help much, decreasing by 0.2 percent in May. Reduced housing starts were also a drag on growth for May's NAI. In contrast, the labor market was a bright spot, with nonfarm payrolls increasing by 280,000 for the month.

The three-month moving average is also closely watched for this measure, and it has been negative for four straight months, up from -0.20 in April to -0.16 in May. While negative, the data continue to indicate a recession is unlikely. When the three-month moving average falls below -0.70, there is an increased likelihood of a recession, and the current data remain consistently better than that threshold. In addition, more recent data hint that a rebound in activity might be forthcoming in the near future, which should improve the NAI moving forward.

Durable Goods Orders and Shipments

The Census Bureau reported that new durable goods orders declined by 1.8 percent in May, extending April's 1.5 percent decrease. Nonetheless, while April's lower data reflected broader softness in the market, the May pullback mainly reflected reduced aircraft sales for the month. Aircraft orders are often bulked together in batches, making them more volatile from month to month. As a whole, transportation equipment orders fell 6.4 percent in May, largely on the decreases for aircraft. Motor vehicle sales were flat. On the positive side, we would expect a significant uptick in this category in the June data, with aircraft sales lifted by the recent Paris Air Show.

Excluding transportation, new durable goods orders were up 0.5 percent in May, rebounding from a 0.3 percent decline in April. That provides a degree of comfort, and yet, we have seen softness in this measure over much of the past year. New durable goods orders excluding transportation measured $157.2 billion in May, down 1.6 percent year-over-year from $159.8 billion in May 2014. Indeed, this broader measure has fallen from $164.3 billion in September, its 2014 peak, but it has also edged marginally higher since bottoming out at $156.0 billion just three months ago.

Looking specifically at the May data, sales increased for computers and electronic products (up 2.2 percent), fabricated metal products (up 0.6 percent), primary metals (up 0.6 percent) and machinery (up 0.4 percent). Core capital goods orders (or nondefense capital goods excluding aircraft) were up 0.4 percent, recovering modestly from the 0.3 percent decline in the prior month. In contrast to these sectors, decreases for May sales included electrical equipment and appliances (down 0.4 percent) and miscellaneous durable goods (down 0.3 percent).

Meanwhile, durable goods shipments were off for the second straight month, down 0.2 percent in April and 0.1 percent in May. Much like new orders, however, shipments excluding transportation equipment were slightly stronger in May, up 0.3 percent. On a year-over-year basis, durable goods shipments have risen modestly, up 2.7 percent, but the data have changed very little since the fall. In May, there were increased shipments for computers and electronic products (up 1.9 percent), machinery (up 0.8 percent) and motor vehicles and parts (up 0.1 percent). Other major sectors declined.

Existing Home Sales

The National Association of Realtors® (NAR) reported that existing home sales jumped from an annualized 5.09 million units in April to 5.35 million units in May. The strong growth in sales, up 5.1 percent for the month, suggested that the existing home market has continued to rebound from softness earlier in the year. Healthy gains in the single-family home market, up 5.6 percent for the month and 9.7 percent year-over-year, fueled May's increase. Multifamily sales were also higher, up 1.6 percent in May and 5.1 percent year-over-year. Overall, existing home sales have grown 9.2 percent since May 2014.

Nonetheless, NAR Chief Economist Lawrence Yun noted tight inventories and rapidly rising prices in the market, saying, "Without solid gains in new home construction, prices will likely stay elevated—even with higher mortgage rates above 4 percent." There were 5.1 months of supply on the market in May, and the median home price sold was $228,700, up 7.9 percent from 12 months ago.

Gross Domestic Product (Second Revision)

The Bureau of Economic Analysis reported that the U.S. economy shrank by 0.2 percent in the first quarter. This second revision improved from the 0.7 percent decline in the previous estimate. Looking at the newer data, the improvement came from slightly better figures for personal consumption, nonresidential fixed investments, inventory replenishment and local and state government spending. Yet, the underlying trends were not altered much.

The largest drag on growth in the first quarter was net exports, subtracting 1.9 percentage points from the headline number. In this revision, the decline in goods exports was slower than in the prior release (down 7.5 percent instead of 14.0 percent), but this was offset by a bigger increase in goods imports (up 7.2 percent instead of 5.1 percent) than originally estimated. A strong dollar and continued softness in economic markets abroad have dampened international demand for manufactured goods exports.

Consumer spending on goods was upwardly revised from a 0.5 percent increase to a gain of 1.0 percent. Nonetheless, this shows the cautiousness of American consumers in the first quarter, with the public somewhat hesitant to increase overall spending. While personal consumption expenditures added 1.4 percentage points to real GDP growth for the quarter, the bulk of that increase stemmed from the service sector, particularly for housing and utilities as well as health care.

Nonresidential fixed investment was also weak in the first quarter, down 2.0 percent. This represented a small improvement from the decline of 2.8 percent in the previous estimate. Much of this decline likely stemmed from reduced investments in the energy sector and its supporting supply chain in light of lower crude oil prices. The largest declines were in structures, with industrial equipment purchases soft across the past two quarters.

Overall, the economy got off to a disappointing start in 2015, with manufacturers facing a number of significant headwinds. While there are signs that demand and production might begin to rebound in the coming months, the market remains soft. The current forecast is for 2.8 percent growth in real GDP for the second quarter and for 2.2 percent growth for 2015 as a whole. This represents a downgrade from the more robust outlook at the beginning of the year, but it would indicate a somewhat better expansion during the second half of the year than in the first.

Kansas City Fed Manufacturing Survey

The Kansas City Federal Reserve Bank reported that manufacturing activity declined for the fourth straight month in June, albeit at a slower pace than in May. The composite index of general business conditions increased from -13 in May to -9 in June. The slower decline for the headline measure stemmed largely from an easing in the decrease of new orders (up from -19 to -3). Still, it is hard to paint this report in a positive manner, with continued sluggishness across the board. For instance, the rate of production weakened even further (down from -13 to -21), with shipments (down from -9 to -15), employment (up from -17 to -9) and exports (up from -9 to -5) all solidly in contraction. Exports have been negative for six consecutive months.

Behind the scenes, manufacturers in the district have grappled with a number of significant challenges to growth. Specifically, these firms have struggled due to lower crude oil prices and the stronger U.S. dollar. At the same time, Chad Wilkerson, a vice president and economist at the Kansas City Federal Reserve, said, "… firms expect some stabilization in the months ahead and for orders to rise by the end of the year."

Indeed, manufacturing respondents see modest increases over the next six months, even as they remain much less optimistic than many of their regional peers. The forward-looking composite index increased from 0 to 3, and new orders (up from 2 to 9), production (up from 6 to 11) and capital spending (up from 0 to 13) picked up for the month. At the same time, hiring remained soft (down from 7 to 0), and the average workweek (up from -13 to -3) narrowed for the third straight month. Meanwhile, exports (up from -2 to 0) were flat in June, which was actually encouraging given that it was the first time since December that the expected export growth rate was not negative.

Markit Flash PMIs for the United States, China, Japan and the Eurozone

The Markit Flash Eurozone Manufacturing PMI increased from 52.2 in May to 52.5 in June, its fastest pace of growth since April 2014. (The composite measure, which adds in services, rose to a 49-month high.) For manufacturers, output (up from 53.3 to 53.5) and employment (up from 51.6 to 52.0) edged higher, with both expanding modestly. At the same time, new orders (down from 52.7 to 52.5) and exports (down from 53.2 to 52.6) eased slightly. Nonetheless, the underlying story is positive, with Europe making significant progress in recent months and brushing off possible risks from Greece. However, robust growth continues to be elusive, with real GDP up 0.4 percent in the first quarter and industrial production up just 0.1 percent in April. On a year-over-year basis, the Eurozone grew 1.0 percent, with industrial output up 0.8 percent.

In contrast, U.S. manufacturing activity declined to its slowest rate of growth since October 2013. The Markit Flash U.S. Manufacturing PMI fell from 54.0 to 53.4, decelerating for the third straight month. Yet, despite that headline, growth in new orders (up from 54.3 to 54.5) and employment (up from 54.6 to 55.0) accelerated slightly in June, with hiring at a seven-month high. The drag on the headline index stemmed mainly from slower output growth (down from 55.2 to 53.9), even as production continued to expand modestly overall. Exports were stagnant for the month (up from 49.7 to 50.0), but they appear to have stabilized after contracting in April and May.

Meanwhile, manufacturers in both China and Japan reported contracting activity in June, but with mixed levels of progress. The HSBC Flash China Manufacturing PMI increased from 49.2 to 49.6. This was the highest level in three months, even as the data indicate that manufacturing activity has contracted in six of the past seven months. In June, new orders shifted to a slight expansion for the first time since February (up from 49.1 to 50.3), and output (up from 49.3 to 50.0) and exports (up from 46.7 to 49.9) improved to being essentially neutral. On the other hand, employment deteriorated further (down from 48.7 to 46.8). Overall, China's economy continues to decelerate, but recent indicators have suggested that at least some of this softness has begun to stabilize.

Japan's economy has been somewhat volatile so far this year, with its PMI data up one month and then down the next. The Markit Flash Japan Manufacturing PMI declined from 50.9 in May to 49.9 in June, returning to where it was in April. Reduced new orders (down from 51.2 to 49.4) were largely responsible for the decrease in overall activity in June, even as the pace of export sales picked up (up from 50.5 to 53.6). Output (down from 51.7 to 50.5) and employment (down from 51.1 to 50.5) decelerated a bit, but continued to grow slightly for the month. On the positive side, Japanese real GDP increased 1.0 percent in the first quarter, its fastest pace since the first quarter of 2014.

Final data points for all measures will come out Wednesday, July 1.

New Home Sales

The Census Bureau and the U.S. Department of Housing and Urban Development reported that new single-family home sales rose 2.2 percent in May. New home sales increased from 534,000 units at the annual rate in April to 546,000 units in May, the fastest pace since February 2008. Sales were stronger in the Northeast and the West, but slower in the Midwest and the South. Overall, new home sales have averaged 528,000 year-to-date, representing some progress after bottoming at 449,000 units as recently as November. Over the past 12 months, new home sales have risen 19.5 percent, up from 457,000 units in May 2014.

There are 4.5 months of supply on the market, down from 5.0 months in March and 4.6 months in April. As such, we have seen inventories of new homes for sale tighten a bit in the past few months. The median sales price was $282,800 in May, down slightly from $285,600 one year ago.

Personal Income and Spending

The Bureau of Economic Analysis reported that personal spending rose 0.9 percent in May, rebounding from a more cautious 0.1 percent growth rate in April. It was the fastest monthly pace since August 2009. From the manufacturing perspective, this was welcome news, with spending on durable and nondurable goods up 2.2 percent and 1.9 percent, respectively. More importantly, it provides some encouragement that Americans might resume opening their wallets—something they have been hesitant to do so far this year. The year-over-year rate of personal spending in May (3.6 percent) was the highest since December, up from 3.1 percent in April.

Meanwhile, personal income growth was also impressive, up 0.5 percent for the second straight month. Across the past 12 months, personal incomes have risen 4.4 percent, up from 4.2 percent in the last report. Total manufacturing wages and salaries were $801.0 billion in May, up from $800.4 billion in April. This continues an upward trend for the sector, with manufacturing wages and salaries on average totaling $747.6 billion in 2013 and $778.8 billion in 2014.

With strong consumer spending data, the savings rate dipped somewhat for the month, down from 5.4 percent in April to 5.1 percent in May. Nonetheless, this continues to be higher than a few months ago, with the savings rate at 4.5 percent as recently as November.

In other news, the personal consumption expenditure (PCE) deflator rose 0.3 percent in May, up from being unchanged in April. This largely reflected an uptick in energy prices, which increased 4.7 percent during the month. Still, even with these gains, energy prices remain 16.8 percent lower than a year ago. On a year-over-year basis, the PCE deflator was up only 0.2 percent, with core inflation, which excludes food and energy prices, up 1.2 percent. This suggests that overall pricing pressures remain quite minimal for the time being, continuing to give the Federal Reserve flexibility in terms of monetary policy—at least for now.

Richmond Fed Manufacturing Survey

The Richmond Federal Reserve Bank reported that manufacturing activity expanded at its fastest pace since January—a sign that the sector has made progress since the spring. The composite index of general business activity improved from 1 in May to 6 in June. Stronger new orders (up from 2 to 11, the highest level since October) boosted the index. Shipments were unchanged for the month (up from -1 to 0), but that represented some stabilization after four straight months of contraction. Overall, this report found modest growth in the manufacturing sector in the district, which, while not as strong as we might prefer, found sentiment moving in the right direction.

The labor market variables were mixed in June, but still slightly positive. The index for the number of employees increased marginally higher (up from 3 to 4), but the average workweek (down from 6 to 5) decreased slightly. Wage growth (down from 20 to 17) continued to be decent, even with a slight easing in this month's measure.

Looking ahead, manufacturers in the region remain mostly upbeat about future sales and production. The expected indices for shipments (up from 34 to 38), new orders (up from 33 to 35) and capacity utilization (up from 25 to 28) for six months from now reflect strong growth in each indicator, and employment (down from 18 to 15) and capital spending (down from 26 to 23) are also seen expanding at healthy paces despite slight decelerations for both in June.

Meanwhile, inflationary pressures have picked up slightly, but remain minimal. Manufacturers in the district said that prices paid for raw materials grew 0.92 percent at the annual rate in June, up from 0.70 percent in May. This pace was down sharply from the 2.22 percent rate in October. In addition, respondents anticipate raw material prices to increase 1.48 percent at the annual rate six months from now, which was essentially unchanged from the 1.47 percent rate in May. This forward-looking measure, however, continues to indicate pricing growth below the Federal Reserve's stated goal of 2 percent.

University of Michigan Consumer Sentiment (Revision)

Consumer confidence picked up again in June, according to final data from the University of Michigan and Thomson Reuters. The Consumer Sentiment Index increased from 90.7 in May to 96.1 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 108.9) and expected (up from 84.2 to 87.8) economic climate.

Questions or comments?

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