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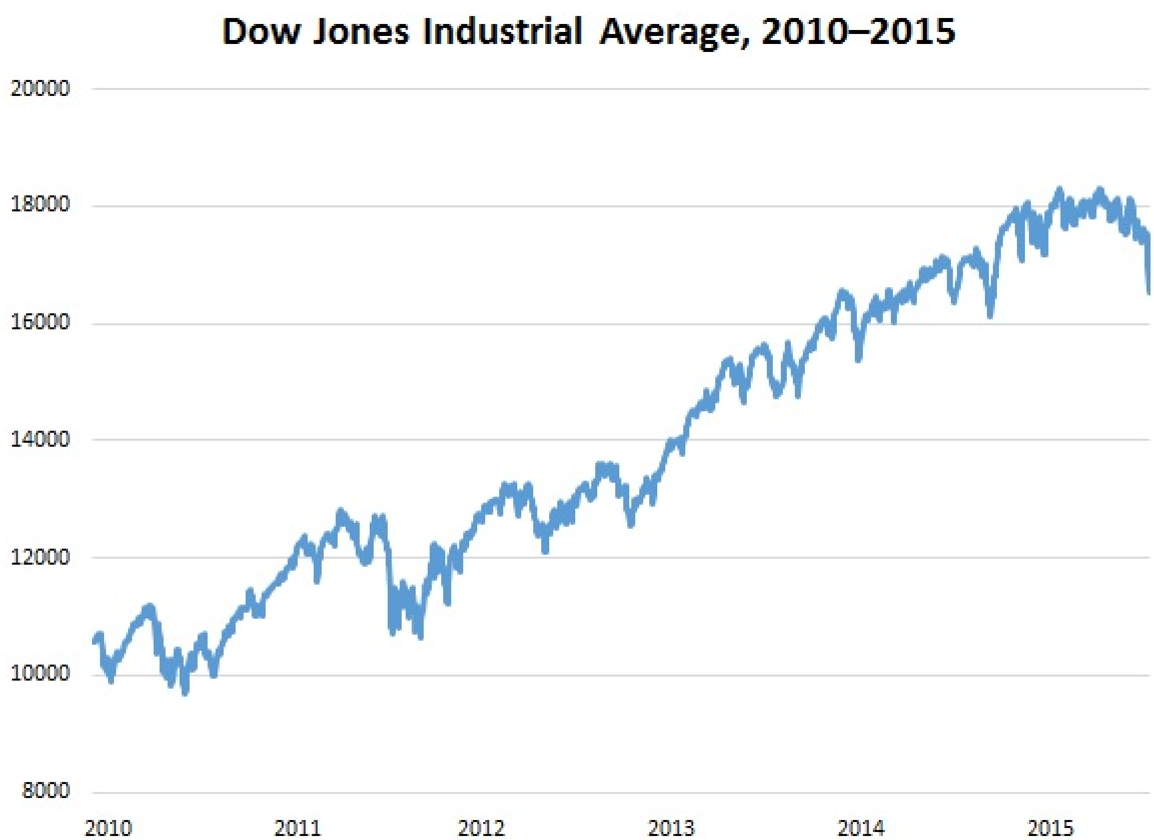
Monday Economic Report

August 24, 2015



The Dow Jones Industrial Average reached an all-time high at 18312.39 on May 19. Since peaking three months ago, the stock market has fallen nearly 10 percent, closing at 16549.75 on August 21, and is poised for more losses today. Much of the decline stemmed from worries about global growth, particularly in China. Indeed, the Caixin Flash China General Manufacturing PMI declined from 47.8 in July to 47.1 in August, its lowest level since March 2009. The Chinese manufacturing sector continues to struggle, with its PMI data contracting for the sixth consecutive month and activity down across the board. This mirrors deceleration in other Chinese economic statistics. With that in mind, the Bank of China has devalued the yuan, down 3.1 percent so far this month, and the Shanghai Composite Stock Market Index has plummeted nearly 38 percent since June 12. Financial markets around the world have responded in kind, worried that slowing growth in China will spill over into other markets.

Closer to home, manufacturers in the United States continue to expand, but with slower growth than desired. Reports released last week showed mixed messages on the sector's overall health. The Markit Flash U.S. Manufacturing PMI decreased from 53.8 to 52.9, the slowest pace of growth since October 2013. New orders and output continued to expand modestly, but export sales contracted for the fourth time this year on the stronger U.S. dollar and weaknesses abroad. The Philadelphia Federal Reserve Bank's survey of manufacturers also noted export softness. In a special question, 23.0 percent of respondents said that exports had fallen either modestly or substantially over the past year, up from 7.0 percent who said the same thing last year. In contrast, the percent noting higher exports dropped from 38.6 percent to 18.8 percent. The New York Federal Reserve Bank's Empire State Manufacturing Survey was even more troubling, with activity contracting at its quickest pace since April 2009, largely on economic anxieties.

On the positive side, the manufacturing leaders who completed the Philadelphia and New York Federal Reserve Bank surveys continued to be cautiously upbeat about the upcoming months, brushing off challenges in the current environment. Signs of growth elsewhere are also encouraging. For instance, many of the indicators coming out of Europe have been promising, particularly in light of worldwide and Greek headwinds. The Markit Flash Eurozone Manufacturing PMI remained unchanged in August, but it has trended generally higher since being essentially stagnant in November. Production expanded at its fastest rate since May 2014, with strong growth in Germany boosting the report. Still, even as Europe continues to make slow-but-steady progress, there are indications that the Eurozone has not fully emerged from its problems. Real GDP growth remains far from robust, up 0.3 percent in the second quarter and 1.2 percent higher year-over-year, and industrial production declined by 0.4 percent in June.

Returning to the U.S. economy, the housing market has been one of the brighter spots of late. New housing starts exceeded 1.2 million in July, reaching their fastest pace since October 2007. This suggests that residential construction has gained some steam, improving from softness earlier in the year. The higher figure last month stemmed largely from the 12.8 percent jump in single-family starts activity, reaching the highest level of single-family activity since December 2007. Multifamily starts and new housing permits data, however, both fell sharply, but this was likely temporary. Despite the decline for the month, for instance, housing permits remain 7.5 percent higher than in July 2014. Moreover, the Housing Market Index from the National Association of Home Builders and Wells Fargo found that home builder confidence rose to its highest level since November 2005, with builders mostly upbeat about single-family sales for the next six months. Existing home sales were also robust, increasing for the third straight month and selling at their briskest pace since before the Great Recession in February 2007.

One of the larger debates of the past week was when the Federal Reserve might begin to raise short-term rates. The minutes of the Federal Open Market Committee (FOMC) meeting from July 28–29 seem to indicate that many members were ready to start normalizing rates at the September 16–17 meeting, but this view was not universally shared. Global economic developments since then might impact that decision, with some pundits suggesting that the FOMC might shift its thinking to the December 15–16 meeting instead, allowing enough time to assess incoming data. Either way, rates will still likely increase by year's end, consistent with statement from Chair Janet Yellen. Core inflation remains quite minimal, of course, providing the Federal Reserve some flexibility in terms of when to act.

This week, we will get more information on the state of the manufacturing sector and the U.S. economy. Regional surveys from the Kansas City and Richmond Federal Reserve Banks will highlight manufacturing activity in their districts; whereas, the Census Bureau will release new data on durable goods orders and shipments for July. Sales of durable goods rebounded in June after declines in both April and May, and we will be looking for signs of continued improvement. Meanwhile, the Bureau of Economic Analysis will revise second quarter real GDP growth, which was originally estimated to increase by 2.3 percent. Other highlights for the week include the latest data on consumer confidence and new home sales.

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*P.S.: If you have not already done so, please take a moment to complete the latest **Manufacturers' Outlook Survey from the National Association of Manufacturers (NAM).** This 20-question survey helps us to gauge how manufacturing sentiment has changed since June's survey. It also includes some special questions on monetary policy, capital spending plans, and proposed overtime and ozone regulations. To complete the survey, click here. Responses are due by **Friday, August 28.** As always, all responses are anonymous.*

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Economic Indicators

Last Week's Indicators:
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New York Fed Manufacturing Survey

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Housing Starts and Permits

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This Week's Indicators:

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Chicago Fed National Activity Index

Tuesday, August 25
Conference Board Consumer Confidence Index
New Home Sales
Richmond Fed Manufacturing Survey

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Durable Goods Orders and Shipments

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Kansas City Fed Manufacturing Survey

Friday, August 28
University of Michigan Consumer Sentiment Index

Summaries for Last Week`s Economic Indicators

Conference Board Leading Indicators

The Conference Board's Leading Economic Index (LEI) declined by 0.2 percent in July, its first decrease in five months. Nonetheless, one should not overinterpret this decrease, with the headline figure pulled lower by a significant decline in housing permits *(see below)*. Absent this component, the LEI would have risen by 0.3

percent, and despite lower permitting in July (some of which was due to extraordinary circumstances), the prospects for the housing market are quite encouraging. In addition, the LEI has risen 1.7 percent over the past six months, providing some encouragement for continued expansion in the U.S. economy moving forward.

Many of the other components to the LEI were positive, including initial unemployment claims, favorable credit conditions, the interest rate spread and consumer confidence. New orders in the manufacturing sector provided a slight boost to the bottom line, as well.

Meanwhile, the Coincident Economic Index (CEI), which assesses current conditions, increased 0.2 percent. Industrial production rebounded in July, adding 0.08 percentage points to the CEI. At the same time, the other three components—nonfarm payrolls, personal income, and manufacturing and trade sales—were positive contributors to the index.

Consumer Price Index

The Bureau of Labor Statistics reported that the Consumer Price Index (CPI) edged up 0.1 percent in July, slowing from the 0.4 percent and 0.3 percent paces observed in May and June, respectively. The easing in the growth of consumer prices stemmed largely from slower energy price increases, which rose 0.1 percent in July after jumping 4.3 percent and 1.7 percent in May and June.

The energy picture was more mixed than the headline figure appears. Gasoline prices increased by 0.9 percent for the month, down from much larger gains in the prior two months. Along those lines, the average price of regular conventional gasoline reached $2.605 per gallon on July 27, up from $2.451 a gallon on April 27, according to the Energy Information Administration (EIA). Despite those gains, gasoline prices remain 22.4 percent lower today than one year ago. At the same time, fuel oil (down 3.4 percent), electricity (down 0.6 percent) and piped-in natural utility gas service (down 1.4 percent) helped to ease the recent increases in gasoline costs.

Meanwhile, food prices also rose 0.2 percent in July, easing a bit from the 0.3 percent increase experienced in June. The cost of food purchased for the home rose 0.3 percent in July, lifted by higher prices for bakery products, eggs, fruits and vegetables, nonalcoholic beverages, pork, and sugars and sweets. In contrast, the prices for beef, fats and oils, fish and seafood, and poultry dipped. Prices for food purchased away from home remained unchanged. In summary, food costs are 1.6 percent higher on a year-over-year basis, up modestly over the past 12 months.

Excluding food and energy, core consumer prices increased by 0.1 percent in July, down from 0.2 percent in June. Higher monthly prices for apparel, medical care and shelter expenses were slightly offset by lower costs for household furnishings, new and used vehicles, and transportation expenses. On a year-over-year basis, core inflation held steady from last month at 1.8 percent. In fact, core consumer prices have remained in the 1.6 to 1.8 percent year-over-year range for 12 straight months. As such, inflationary pressures continue to be minimal, with core CPI remaining below 2 percent now for 29 straight months.

With pricing pressures below the Federal Reserve's stated goal, it has been free to continue its stimulative policies without worry of inflation, at least for now. Nonetheless, the Federal Reserve is expected to start raising short-term rates later this year.

Existing Home Sales

The National Association of Realtors® saw existing home sales increase for the third straight month, up 2.0 percent in July to 5.59 million units. This marks the fastest pace since February 2007. The growth stemmed largely from a 2.7 percent increase in sales for single-family homes, with multifamily units down 3.1 percent for the month. Still, the longer-term trend remains positive for both categories, with single-family and multifamily units up 11.0 percent and 5.0 percent year-over-year, respectively. In July, existing home sales in the South and West strengthened, with some softness seen in the Northeast and flat sales in the Midwest.

With strong growth in sales, inventories have fallen. July had 4.8 months of supply on the market, down from 5.2 months in April. This has helped to push prices higher, with the median price for an existing home sale of $234,000 in July, up 5.6 percent year-over-year.

Housing Starts and Permits

The Census Bureau and the U.S. Department of Housing and Urban Development reported that new housing starts now exceed 1.2 million, reaching their fastest pace in July since October 2007. New housing starts edged marginally higher, up from a revised 1,204,000 units at the annual rate in June to 1,206,000 in July. (June's figure was originally estimated to be 1,174,000.) This report suggests that the housing market has gained some steam, improving from softness earlier in the year. To illustrate this progress, housing starts averaged 1,039,200 through the first five months of 2015. In addition, housing starts have increased 10.8 percent year-over-year.

The higher figure in July stemmed largely from the 12.8 percent jump in single-family starts activity, up from an annualized 693,000 to 782,000. This marks the highest level of single-family activity since December 2007, the first month of the Great Recession. The increase also offset the decline in multi-family starts, which fell from 511,000 to 424,000, or down 17.0 percent. The multi-family data are often highly volatile, and it is clear that the June figure was an outlier. Indeed, multi-family housing starts averaged 367,000 through the first five months of the year, which is more in line with where we would expect the July figure to be.

In contrast to the encouraging news for housing starts, residential permitting declined sharply in July, down 16.3 percent. Housing permits decreased from an annualized 1,337,000 in June to 1,119,000 in July. A fair share of this decline likely came from the expiration of tax credits at the end of June in New York, which skewed the figures in both June and July. Single-family permitting also dipped, from 692,000 to 679,000, but the biggest declines were seen in the multi-family segment, down from 645,000 to 440,000. Look for the permitting data to stabilize moving forward. In general, activity has moved in the right direction, even if it the latest report doesn't clearly show this. For instance, despite the decline for the month, housing permits remain 7.5 percent higher than they were in July 2014.

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

The Caixin Flash China General Manufacturing PMI declined from 47.8 in July to 47.1 in August, its lowest level since March 2009. The Chinese manufacturing sector continues to struggle, with its PMI data contracting for the sixth consecutive month. Manufacturing activity dipped across the board, including new orders (down from 47.2 to 46.3), output (down from 47.1 to 46.6), exports (down from 46.9 to 46.0) and employment (down from 47.2 to 46.0). The new orders also hit a post-recessionary low. Indeed, a number of economic statistics continue to reflect decelerating activity levels, particularly relative to the paces observed earlier in the year or last year. These include industrial production, fixed asset investments and retail sales. With that in mind, the Bank of China has devalued the yuan, down 2.9 percent in the past two weeks, and the Shanghai Composite Stock Market Index has plummeted more than 32 percent since June 12. Such sharp moves have prompted growth worries in financial markets around the world.

Closer to home, the Markit Flash U.S. Manufacturing PMI decreased from 53.8 to 52.9, for its slowest pace of growth since October 2013. Manufacturers in the United States continue to expand, but with growth easing in the past month. For instance, new orders (down from 55.0 to 54.7), output (down from 55.4 to 53.7) and employment (down from 53.7 to 52.2) each decelerated somewhat in August, despite expanding at a modest pace. However, exports (down from 51.3 to 49.8) contracted for the fourth time so far this year. The stronger U.S. dollar and sluggishness in export markets have hurt manufacturers' ability to increase their international sales, weakening overall activity.

Yet, there were also some more-encouraging signs of manufacturing elsewhere. For instance, the Nikkei Flash Japan Manufacturing PMI increased from 51.2 to 51.9, the fastest pace since January. The headline number improved on stronger growth in new orders (up from 51.3 to 53.2), a 10-month high. Of course, other areas eased a bit for the month, even as they continued to expand. This included output (down from 52.3 to 51.9), exports (down from 52.3 to 50.5) and hiring (down from 51.1 to 50.9). Digging a little deeper into other macroeconomic variables, industrial production rebounded in June, up 1.1 percent and 2.3 percent higher year-over-year. Still, growth remains weaker than desired, with real GDP down 0.4 percent in the second quarter.

Meanwhile, the Markit Flash Eurozone Manufacturing PMI stayed flat at 52.4, mostly brushing off global and Greek anxieties over the past several weeks. In fact, growth in manufacturing activity has held relatively steady, with the sector improving since being essentially stagnant in November (50.1). New orders (up from 52.2 to 52.7), output (up from 53.6 to 53.8), exports (up from 51.5 to 52.6) and employment (up from 51.8 to 52.2) saw modest gains. Production expanded at its fastest rate since May 2014, and strong growth in Germany (up from 51.8 to 53.2) boosted the report. Still, even as Europe continues to make slow-but-steady progress, there are also indications that the Eurozone has not fully emerged from its problems. Real GDP growth remains far from robust, up 0.3 percent in the second quarter and 1.2 percent higher year-over-year, and industrial production declined by 0.4 percent in June.

Final PMI data releases for each of these reports will come out on Tuesday, September 1.

NAHB Housing Market Index

The National Association of Home Builders (NAHB) and Wells Fargo reported rising confidence in August, reaching its highest level since November 2005. The Housing Market Index (HMI) rose from 60 in July to 61 in August, marking its 14th straight month of exceeding 50, the threshold at which more home builders are positive than negative in their outlook. Moreover, this report suggests that the housing sector has picked up some steam since the spring months, when the HMI bottomed out at 52 in March. The Midwest and the West saw the largest increases, with all regions showing strength overall.

“Today’s report is consistent with our forecast for a gradual strengthening of the single-family housing sector in 2015,” NAHB Chief Economist David Crowe said. “Job and economic gains should keep the market moving forward at a modest pace throughout the rest of the year.”

New York Federal Reserve Bank Manufacturing Survey

The Empire State Manufacturing Survey contracted in August at the steepest rate since the Great Recession. The composite index of general business conditions from the New York Federal Reserve Bank declined sharply from 3.9 in July to -14.9 in August, its lowest level since April 2009. With that said, the Empire State survey’s headline figure has bounced around a lot over the past five months, up one month and then down the next. It contracted three times in that time frame. Overall, it is safe to suggest that manufacturers in the New York Federal Reserve Bank region continue to report softness in the current economic environment, led by reduced demand and shipments, even as they remain cautiously upbeat moving forward.

The underlying data support this view. New orders have contracted in five of the past six months. In this report, the index for new orders (down from -3.5 to -15.7) plummeted, with the percentage of respondents saying their orders had declined in the month dropping from 28.8 percent in July to 34.4 percent in August. At the same time, the percentage noting increased sales dropped from 25.3 percent to 18.7 percent. Likewise, shipments (down from 7.9 to -13.8) contracted for the first time in just over two years—a sign that activity has pulled back significantly in the region. In addition, hiring (down from 3.2 to 1.8) slowed to a near crawl, and the average workweek (down from 4.3 to -1.8) narrowed once again after expanding in the prior two months.

Such findings might be more worrisome if it were not for the more optimistic forward-looking indicators. Indeed, the overall index for general business conditions six months from now rose from 27.0 to 33.6. Respondents expect new orders (down from 32.2 to 29.4) to expand strongly in the months to come, despite some easing in confidence in August. The same could be said for shipments (up from 25.4 to 33.0), capital expenditures (down from 21.3 to 17.3) and technology spending (up from 10.6 to 13.6). On the other hand, respondents anticipate the labor market to grow more modestly, including hiring (down from 9.6 to 3.6) and the average workweek (up from -3.2 to 1.8).

Philadelphia Federal Reserve Bank Manufacturing Survey

The Federal Reserve Bank of Philadelphia saw growth in the manufacturing sector in its district expand modestly in August, picking up slightly from July. The composite index of general business activity increased from 5.7 in July to 8.3 in August. While this suggests some improvement for the month, growth in activity has decelerated since June's 15.2 reading—the highest level so far in 2015. The headline figure rose primarily on strength in shipments (up from 4.4 to 16.7), with 36.0 percent of respondents suggesting that their shipments were higher in August, up from 23.5 percent in July. Similarly, hiring (up from -0.4 to 5.3) accelerated somewhat, with the percentage of those completing the survey reporting increased employment, up from 12.0 percent to 21.1 percent. The average workweek (up from 4.0 to 8.5) also lengthened.

At the same time, this month's report presented some mixed signs. For instance, new orders (down from 7.1 to 5.8) slowed a little, with the percentage of respondents suggesting that sales had declined edging marginally higher, from 24.7 percent to 25.9 percent. In both month's reports, 31.7 percent of those surveyed reported higher new orders; hence, a modest growth in demand on net.

One of the major challenges for manufacturers continues to be exports, with the strong U.S. dollar and softer economic growth abroad dampening international sales. In a special question, respondents were asked about total export sales, and 23.0 percent said that exports had fallen either modestly or substantially over the past year, up from 7.0 percent who said the same thing last year. In contrast, the percentage noting higher exports dropped from 38.6 percent to 18.8 percent.

Despite some of these current headwinds, manufacturers in the Philadelphia Federal Reserve Bank's district remain mostly upbeat about the next six months. The future-oriented composite index rose from 41.5 to 43.1, with more than half of business leaders anticipating higher new orders and shipments and roughly 30 percent expecting additional hiring and capital spending in the coming months. The one drag might be higher raw material costs, with just more than 38 percent seeing input prices rising in the months ahead. Yet, it must be said that overall inflationary pressures continue to be modest, even with a pickup in the next six months.

State Employment Report

California added the most net new manufacturing jobs in July, with 4,700 additional workers in the sector for the month. New York (up 4,600), Florida (up 2,000), Michigan (up 1,700), North Carolina (up 1,600) and Tennessee (up 1,600) followed suit. Several of these states were also ranked highly when looking at manufacturing growth year-over-year. Since July 2014, Michigan (up 22,000), Ohio (up 15,000), North Carolina (up 12,600), Indiana (up 11,800), Wisconsin (up 8,800), California (up 8,000) and Oregon (up 8,000) made the largest strides in manufacturing employment growth.

Looking at the unemployment rate, Nebraska (2.7 percent) has the honor of having the lowest in the nation. North Dakota (3.0 percent), Utah (3.6 percent), Vermont (3.6 percent), Hawaii (3.7 percent), New Hampshire (3.7 percent), Iowa (3.8 percent) and South Dakota (3.8 percent) also rang in significantly below the 5.3 percent national average. At the other end of the spectrum, West Virginia (7.5 percent), the District of Columbia (6.8 percent), Nevada (6.8 percent), Alaska (6.7 percent), Mississippi (6.5 percent) and New Mexico (6.5 percent) saw the highest rates of unemployment.

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