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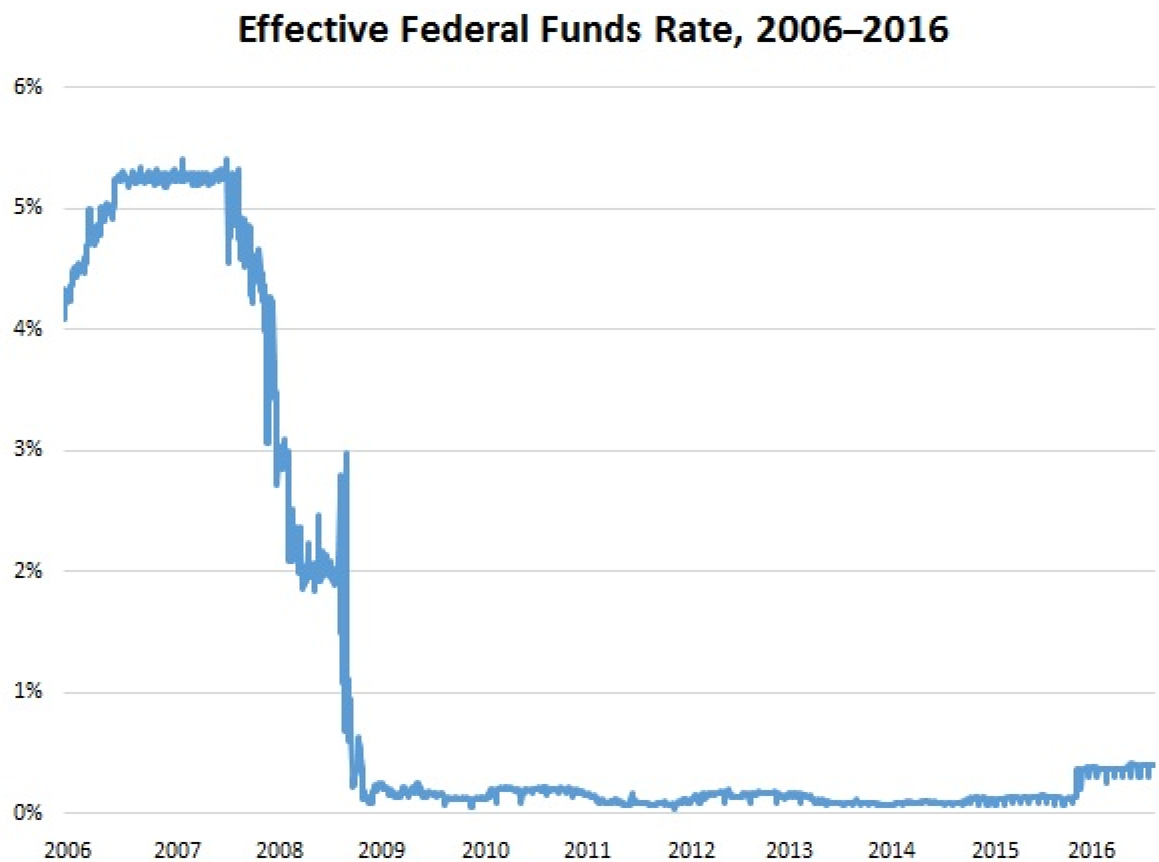
Monday Economic Report

September 26, 2016



The biggest economic news last week was also the most predictable. The Federal Open Market Committee (FOMC) left short-term interest rates unchanged at the conclusion of its September 20–21 meeting as expected. While the Federal Reserve felt that "the case for an increase in the federal funds rate has strengthened," it will hit the pause button for now, setting up the possibility of a rate hike at its December 13–14 meeting, mirroring consensus expectations. (The FOMC does have another meeting scheduled for November 1–2 but will not likely act just a few days before Election Day.) Moreover, the Federal Reserve's economic projections would seem to imply one increase this year (in December), with two rate hikes next year and three rate hikes in both 2018 and 2019.

Looking more closely at the Federal Reserve outlook tables, participants slightly lowered their estimates of growth for this year. They now see the U.S. economy growing 1.8 percent in 2016, down from an estimate of 2.0 percent in June. In addition, FOMC members predict the unemployment rate will be 4.8 percent at year's end, or marginally higher than the 4.7 percent forecast three months ago. The Federal Reserve outlook calls for 2.0 percent growth in 2017, with the unemployment rate falling to 4.6 percent. In terms of pricing pressures, participants see personal consumption expenditure (PCE) inflation of 1.3 percent this year, with core PCE growth of 1.7 percent.

As noted in the past two Monday reports, much of the economic data of late has been disappointing, particularly for August. This has included manufacturing production, employment and retail sales, and last week, we added housing starts to that list. New residential construction activity decreased from an annualized 1,212,000 units in July to 1,142,000 units in August, a decline of 5.8 percent. Existing home sales were also off, down from 5.38 million units at the annual rate in July to 5.33 million units in August, with inventories continuing to drift lower. Both of these reports stood in contrast to a strong jump in homebuilder confidence. That figure suggested builders were quite optimistic about the next six months, spurred by modest economic growth and historically low mortgage rates. Along those lines, I continue to expect 1.21 million housing units started by year's end despite the weaker-than-desired numbers for August, particularly for single-family activity.

Manufacturing data were mixed last week. The Markit Flash U.S. Manufacturing PMI edged down from 52.0 in August to 51.4 in September, falling to a three-month low. This speaks to the sluggishness of manufacturing activity, with new orders decelerating to the slowest pace of growth since July 2011. Exports also returned to negative territory after three months of gains, as manufacturers in the United States struggled with the strong dollar and weaknesses abroad. On the positive side, however, manufacturing activity rebounded in the Kansas City Federal Reserve Bank's district in September.

Meanwhile, Eurozone reports were somewhat split, with manufacturing sentiment ticking higher, up to its highest level since June, but service-sector growth dropping to its slowest growth rate since December 2014. The overall Eurozone data mirror the report from Germany for manufacturing (up from 53.6 to 54.3), including achieving a three-month high, while the contraction in activity in France (up from 48.3 to 49.5) slowed on a stabilization in output.

We will get new reads on the manufacturing sector this week. This will include the latest data on durable goods orders and shipments for August and surveys from the Dallas and Richmond Federal Reserve Banks for September. More than anything, we will be looking for signs of a possible rebound in the September numbers. Beyond manufacturing, there will also be important reports on advance goods exports and personal income and spending that will be closely watched, with other highlights being a second revision for second-quarter real GDP and new releases for consumer confidence and new home sales.

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PS: I hope you can attend the NAM's upcoming Leading Edge Executive Forum in Chicago on October 13 on how sustainability decisions are driving value in products, reputation and workforce development. I encourage you to register here to join us for this exclusive discussion with top manufacturing leaders on sustainability.

Economic Indicators

Last Week's Indicators: (Summaries Appear Below)	This Week's Indicators:
Monday, September 19	**Monday, September 26**
NAHB Housing Market Index	Dallas Fed Manufacturing Survey New Home Sales

Tuesday, September 20
Housing Starts and Permits
State Employment Report

Wednesday, September 21
FOMC Monetary Policy Statement

Thursday, September 22
Chicago Fed National Activity Index
Conference Board Leading Indicators
Existing Home Sales
Kansas City Fed Manufacturing Survey

Friday, September 23
Markit Flash PMIs for the United States and Eurozone

Tuesday, September 27
Conference Board Consumer Confidence
Richmond Fed Manufacturing Survey

Wednesday, September 28
Durable Goods Orders and Shipments

Thursday, September 29
Census Advance Economic Indicators Report
Gross Domestic Product (Second Revision)

Friday, September 30
Personal Income and Spending
University of Michigan Consumer Sentiment (Revision)

Summaries for Last Week`s Economic Indicators

Chicago Fed National Activity Index
The Chicago Federal Reserve Bank reported that the U.S. economy softened in August after rebounding somewhat in the prior two months. The National Activity Index (NAI) dropped from 0.24 in July to -0.55 in August, a three-month low. Index readings below zero suggest that the economy is growing below its historical trend, with positive readings indicating the opposite. Much of the shift in this month's report came from manufacturing, with production-related indicators subtracting 0.33 from the headline number after adding 0.15 in the prior release. Indeed, manufacturing production declined 0.4 percent in August, mirroring disappointing data for employment, housing starts and retail sales.

Nonetheless, the three-month moving average edged up from -0.09 in July to -0.07 in August. This was a mathematical result of dropping May's -0.60 reading from the latest figure. Still, the three-month moving average has been negative for 19 consecutive months, illustrating the sluggishness in the U.S. economy since the beginning of 2015. However, the three-month moving average has yet to cross -0.70, the threshold at which the NAI would start to indicate an increased recession risk.

Conference Board Leading Indicators

The Conference Board's Leading Economic Index (LEI) decreased 0.2 percent in August, declining for the first time since May. Over the past six months, the LEI rose just 0.9 percent, illustrating a sluggish—but still very modest—pace of growth for the U.S. economy this year. Manufacturing served as a drag on the LEI, including declines for new orders and a reduced workweek for production workers. Average weekly employment claims, building permits and consumer confidence also provided a negative contribution in this month's LEI report. At the same time, financial markets were a positive element in this release, including the S&P 500, the interest rate spread and overall lending conditions.

In contrast, the Coincident Economic Index (CEI), which assesses current conditions, edged up 0.1 percent in August. This was true despite weak industrial production data, which pulled the CEI lower. Still, the other three components of the CEI—nonfarm payrolls, personal income and manufacturing and trade sales—were positive contributors to the index in August, offsetting the drag from industrial production.

Existing Home Sales

The National Association of Realtors reported that existing home sales were down from 5.38 million units at the annual rate in July to 5.33 million units in August. It was the second straight easing in activity, down from 5.57 million units in June, its fastest pace since the Great Recession. On a year-over-year basis, existing home sales have edged up 0.8 percent from the 5.29 million reading in August 2015. The underlying data were mixed in this report, with single-family sales down from 4.81 million to 4.70 million but condo/co-op sales up from 570,000 to 630,000. Over the past 12 months, both single-family (up 0.6 percent) and condo/co-op (up 1.6 percent) existing home sales were slightly higher.

Inventories of existing homes for sale have drifted lower over the past three months, down from 2.12 million units at the annual rate in May to 2.04 million units in August. Indeed, inventories were down 3.3 percent in August or 10.1 percent year-over-year. That has helped to boost prices, with the median sales price up 5.1 percent over the past 12 months, up from $228,500 in August 2015 to $240,200 now.

FOMC Monetary Policy Statement

The FOMC left short-term interest rates unchanged at the conclusion of its September 20–21 meeting as expected. Indeed, in the latest NAM Manufacturers' Outlook Survey, 45.5 percent of respondents felt the Federal Reserve would wait until its December 13–14 meeting, mirroring consensus expectations. (The FOMC does have another meeting scheduled for November 1–2 but will not likely act just a few days before Election Day.) The press release sets up a possible rate hike later this year, with the following language: "The Committee judges that the case for an increase in the federal funds rate has strengthened but decided, for the time being, to wait for further evidence of continued progress toward its objectives." Recent softness in a number of economic measures was enough for the FOMC to hit the pause button—at least for now.

Interestingly, FOMC participants were highly split on the timing of the next rate hike, as judged by the final vote on this decision. Three regional Federal Reserve Bank presidents—Esther George (Kansas City), Loretta Mester (Cleveland) and Eric Rosengren (Boston)—dissented, with "each [preferring] at this meeting to raise the target range for the federal funds rate to 1/2 to 3/4 percent." That was the largest number of dissents to a policy statement since December 2014.

In addition to the FOMC statement, the Federal Reserve also updated its economic projections, slightly lowering its outlook for this year. Participants now see the U.S. economy growing 1.8 percent in 2016, down from an estimate of 2.0 percent in June. In addition, FOMC members predict the unemployment rate will be 4.8 percent at year's end, or marginally higher than the 4.7 percent forecast three months ago. The Federal Reserve outlook calls for 2.0 percent growth in 2017, with the unemployment rate falling to 4.6 percent. In terms of pricing pressures, participants see PCE inflation of 1.3 percent this year, with core PCE growth of 1.7 percent.

The outlook also provides clues about future actions. The federal funds rate, which is currently 0.375 percent, is predicted to increase to 0.6 percent in 2016, 1.1 percent in 2017, 1.9 percent in 2018 and 2.6 percent in 2019. That would imply one increase this year (in December), with two rate hikes next year and three rate hikes in both 2018 and 2019. That is a slower pace of normalization that was seen in June, which called for two rate hikes this year and had the federal funds rate rising to 2.4 percent by 2018.

Housing Starts and Permits

The Census Bureau and the U.S. Department of Housing and Urban Development reported that new housing starts were weaker in August, once again pulling back after passing the 1.2 million units threshold. New residential construction activity decreased from an annualized 1,212,000 units in July to 1,142,000 in August, a decline of 5.8 percent. As such, it stood in contrast to a strong jump in homebuilder confidence (see below). That figure suggested builders were quite optimistic about the next six months, spurred by modest economic growth and historically low mortgage rates. Along those lines, I continue to expect 1.21 million housing units started by year's end despite the disappointing numbers for August, particularly for single-family activity.

Both single-family (down from 768,000 to 722,000) and multifamily (down from 444,000 to 420,000) starts data were lower in this report. New single-family residential construction activity grew at its slowest pace in 10 months, with a year-over-year decline of 1.2 percent. At the same time, the multifamily starting pace, while at its lowest level since May, has drifted higher year-to-date, up from 353,000 in January. Since August 2015, multifamily starts have edged up 4.7 percent. Yet, that trend likely reflects month-to-month volatility. Along those lines, multifamily starts have averaged 395,125 per month in 2016 through August, which was virtually unchanged from the 395,333 average during all of 2016. That would seem to indicate a relatively stagnant longer-term trend from 2015 forward.

Meanwhile, housing permits were also off marginally, down from 1,144,000 to 1,139,000. The lower headline number stemmed from reduced multifamily permitting, down from 433,000 to 402,000, whereas single-family permits were higher, up from 711,000 to 737,000. Much like the housing starts numbers, the year-over-year data were lower, down 2.3 percent since August 2015.

Kansas City Fed Manufacturing Survey

Manufacturing activity rebounded in the Kansas City Federal Reserve Bank's district in September, expanding after two months of declines. The composite index of general business conditions increased from -4 in August to 6 in September, its fastest pace of growth since December 2014. Indeed, there were rather strong gains for new orders (up from -7 to 12), production (up from -7 to 15) and shipments (up from -4 to 16) to support the improved sentiment in this survey's headline number. To be fair, however, the sector also continues to have a number of challenges. Most notably, that includes exports (up from -10 to -4), which contracted for the eighth consecutive month. Manufacturers in the Kansas City region—not unlike their peers in other districts—have had to grapple with a strong U.S. dollar and weaknesses abroad, both of which have dampened international demand.

The labor market data were mixed. On the one hand, hiring activity remains soft (up from -10 to -3), even with some easing in the rate of decline in September. The index for the number of employees has been negative now for 21 straight months. At the same time, employers appear to be expanding hours worked (up from 4 to 5), with that measure positive for the fourth consecutive report. Sample comments tended to highlight challenges with attracting new talent, highlighting the skills gap in the sector.

Meanwhile, manufacturers continue to be somewhat upbeat about the next six months. The forward-looking composite index edged down from 11 to 10, but it has now been positive each month since April. At least 40 percent of respondents expect sales and output to grow moving forward, which is somewhat promising. Yet, respondents were also less hopeful for hiring, capital spending and export growth over the next six months, showing how cautious business leaders are right now, with expected growth remaining negative.

Markit Flash PMIs for the United States and Eurozone

The Markit Flash U.S. Manufacturing PMI edged down from 52.0 in August to 51.4 in September, falling to a three-month low. This speaks to the sluggishness of manufacturing activity, with new orders decelerating to the slowest pace of growth since July 2011 (down from 52.7 to 51.0). Output (down from 53.9 to 52.3) also eased, albeit with still-modest growth. At the same time, hiring improved (up from 50.6 to 52.5). One of the larger challenges for manufacturers in the United States has been the strong dollar and weaknesses abroad, and in this latest survey, exports contracted slightly once again, turning negative in September after three months of gains (down from 53.1 to 49.8).

In contrast, Eurozone manufacturing activity ticked slightly higher in September. The Markit Flash Eurozone Manufacturing PMI increased from 51.7 to 52.6, its highest level since June (52.8). The pickup in sentiment stemmed from accelerated expansions for new orders (up from 51.4 to 53.0), exports (up from 51.9 to 53.4), output (up from 53.3 to 54.0) and hiring (up from 51.1 to 52.3), each of which grew modestly for the month. This was encouraging news, as it shows that European manufacturers are moving on from softness in the aftermath of the Brexit vote in June and from ongoing global uncertainties. At the same time, the data were not all positive for Europe. The Markit Flash Eurozone Services PMI dropped from 52.8 to 52.1, its slowest growth rate since December 2014.

The overall Eurozone data mirror the report from Germany for manufacturing (up from 53.6 to 54.3), including achieving a three-month high, while the contraction in activity in France slowed on a stabilization in output (up from 48.3 to 49.5). It was the seventh consecutive month with negative growth in manufacturing activity in France; yet, the services sector was a bright spot, expanding at its fastest pace since June 2015.

NAHB Housing Market Index

The National Association of Home Builders (NAHB) and Wells Fargo reported that confidence jumped significantly in September. The Housing Market Index (HMI) rose from 59 in August to 65 in September, its highest level in 11 months. After hovering around 58 from February through August, this is perhaps a sign of renewed strength in the housing market, with homebuilder outlook improving sharply. NAHB Chief Economist Robert Dietz added, “With the inventory of new and existing homes remaining tight, builders are confident that if they can build more homes, they can sell them.” He also noted historically low interest rates, with 30-year fixed mortgage rates averaging just 3.48 percent on September 22, according to Freddie Mac. That should help to fuel not only more housing sales but also continued demand for refinancing.

HMI readings above 50 suggest that more builders are positive in their outlook than negative, and this headline reading has been above that threshold in every month since June 2014, or for more than two years. In addition to the current economic environment, builders continued to predict relatively strong growth in single-family sales over the next six months, with the expectations index rising from 66 to 71 in this report.

State Employment Report

Florida created the most net new manufacturing jobs in August, according to the Bureau of Labor Statistics, adding 4,800 workers for the month. North Carolina (up 1,400) and Virginia (up 1,300) also topped the list of manufacturing employment gains in August. In addition, Florida topped the list for the greatest job gains over the past 12 months, with manufacturing employment in the state up 15,200 since August 2015. Other states with the fastest manufacturing job growth year-over-year included Michigan (up 9,100), Tennessee (up 8,700), Georgia (up 5,200) and Utah (up 4,300).

The national unemployment rate was unchanged at 4.9 percent in August. The lowest unemployment rate in the country was South Dakota at 2.9 percent. A number of states were not far behind, including New Hampshire (3.0 percent), North Dakota (3.1 percent), Nebraska (3.2 percent), Vermont (3.3 percent) and Hawaii (3.4 percent). In contrast, the highest unemployment rates were in Alaska (6.8 percent), New Mexico (6.6 percent), Louisiana (6.3 percent), Nevada (6.3 percent), the District of Columbia (6.0 percent) and Mississippi (6.0 percent).

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