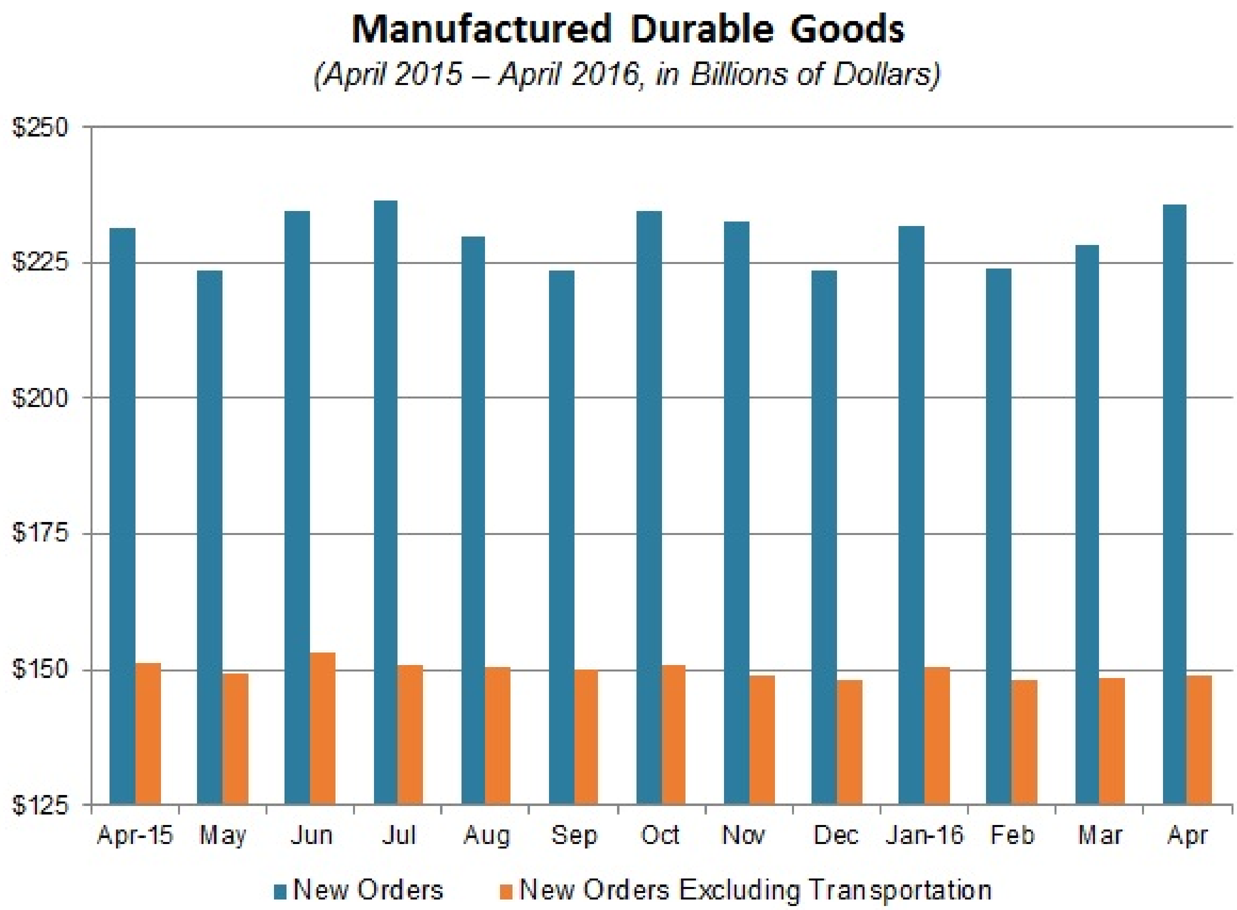
A Publication of the National Association of Manufacturers

Monday Economic Report

May 31, 2016



The Bureau of Economic Analysis reported that the U.S. economy grew 0.8 percent in the first quarter of 2016, up from the prior estimate of 0.5 percent. The revision stemmed from better fixed investment, inventories and net exports data. Nonetheless, the economy remained challenged, with the improvements in these categories reducing the pace to which each was a drag on real GDP growth. Overall, U.S. economic growth has been disappointing through the first three months of 2016, extending the sluggishness at the end of 2015. Indeed, the underlying story remained the same as noted in the prior release. Consumers and businesses were cautious in the first quarter, dampening real GDP growth, and the strong U.S. dollar and struggling economies abroad meant that net exports subtracted from growth in the quarter.

We have become accustomed to having a bad first quarter followed by a strong rebound in the second quarter. In 2015, for instance, first and second quarter real GDP growth was 0.6 percent and 3.9 percent, respectively. I continue to expect a rebound in the current quarter as well, with my forecast for second quarter 2016 growth currently at 2.5 percent. For 2016 as a whole, I am predicting 2.0 percent growth.

Meanwhile, the data on manufacturing activity released last week provided mixed news, but mostly highlighted ongoing struggles. On the positive side, new durable goods orders increased 3.4 percent in April, extending the 1.9 percent gain in March. Yet, much of that gain came from transportation equipment, particularly aircraft sales. Excluding transportation, new orders for durable goods increased just 0.4 percent, and over the past 12 months, that figure was down 1.4 percent. This suggests that demand remains somewhat weaker than the headline number would seem to indicate—a sign that durable goods manufacturers continue to be challenged beyond automobiles and aircraft. The figures on durable goods shipments were similar.

Along those lines, manufacturing sentiment surveys out last week reflected the current weaknesses in the market. The Markit Flash U.S. Manufacturing PMI declined to its slowest pace since September 2009, rebuffing expectations of a possible rebound in May, on reduced output and exports. With that said, new orders grew modestly, with some easing in May, and hiring accelerated. Activity in the Eurozone also edged lower, with manufacturers on the continent experiencing modest growth in demand and production but also lingering political worries, especially in the lead-up to next month's "Brexit" vote. Meanwhile, manufacturers in the Kansas City and Richmond Federal Reserve Bank districts reported contracting activity levels once again in May. Agricultural and energy markets have struggled in the Kansas City region, hurting manufacturers in that district across the past year or more. Despite these current challenges, respondents in both surveys were cautiously positive about the next six months.

Beyond those reports, there were signs in the broader macroeconomy that were promising. One of the brighter spots in the U.S. economy over the past year has been the housing market, as shown in the GDP release discussed above. We got another indication of that last week with news that new residential sales jumped 16.6 percent in April, the strongest pace for new single-family home sales since January 2008. Over the past 12 months, new home sales have grown 23.8 percent—a sign that residential investment continues to move in the right direction. Another important indicator to watch is consumer sentiment, particularly given the pullback in spending in the first quarter. According to the University of Michigan and Thomson Reuters, consumer confidence rose to its highest level since June 2015, which was encouraging. At the same time, consumers still remain somewhat cautious.

Manufacturing activity, employment and international trade will dominate the economic headlines this week. In particular, manufacturer sentiment expanded for two straight months in the Institute for Supply Management's (ISM) survey, following five months of declines. We hope that the latest ISM Manufacturing Purchasing Managers' Index (PMI) will continue to reflect stabilization in the manufacturing sector, with expanding new orders and shipments. In addition, we will get regional survey data from the Dallas Federal Reserve Bank, with the Census Bureau providing data on factory orders and shipments and the U.S. trade deficit. On this latter point, manufactured goods exports were down 5.7 percent year-to-date in the first quarter. Preliminary data from the Census Bureau out last week suggested that the goods trade deficit widened somewhat in April.

The other big story of the week will come on Friday, with the release of May jobs numbers. With the Federal Reserve contemplating raising short-term interest rates again at its June meeting, employment growth in this release will be highly scrutinized, with strong hiring likely tipping the scales toward a rate hike. At the same time, manufacturing job growth has been very soft, up just 4,000 in April but down 23,000 through the first four months of 2016. Look for continued weakness in hiring in the sector, though job growth for manufacturers is likely to be slightly positive in May. Other highlights for the week include the latest data on construction spending, consumer confidence and personal income and spending.

Chad Moutray, Ph.D., CBE
Chief Economist
National Association of Manufacturers

*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.** This 24-question survey helps us to gauge how manufacturing sentiment has changed since March's survey. It also includes special questions on monetary policy, regulatory compliance costs, health insurance, tax reform and international trade.*

*To complete the survey, click here. Responses are due by **Tuesday, May 31, 2016,** at 12:00 p.m. EDT. As always, all responses are anonymous.*

Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

Monday, May 23
Markit Flash Manufacturing PMIs for the United States and Eurozone

Tuesday, May 24
New Home Sales
Richmond Fed Manufacturing Survey

Wednesday, May 25
International Trade in Goods (Preliminary)

Thursday, May 26
Durable Goods Orders and Shipments
Kansas City Fed Manufacturing Survey

Friday, May 27
Gross Domestic Product (Revised)
University of Michigan Consumer Sentiment (Revised)

This Week's Indicators:

Monday, May 30
MEMORIAL DAY HOLIDAY

Tuesday, May 31
Conference Board Consumer Confidence
Dallas Fed Manufacturing Survey
Personal Income and Spending

Wednesday, June 1
Construction Spending
ISM Manufacturing Purchasing Managers' Index

Thursday, June 2
ADP National Employment Report

Friday, June 3
BLS National Employment Report
Factory Orders and Shipments
International Trade

Summaries for Last Week`s Economic Indicators

Durable Goods Orders and Shipments

The Census Bureau reported that new durable goods orders increased 3.4 percent in April, extending the

1.9 percent gain in March. Sales of new durable goods orders rose from $228.3 billion in March to $235.9 billion in April. Demand has risen in three of the four months so far in 2016, providing some encouragement for a sector that has experienced its share of softness over the past year. On a year-over-year basis, sales have risen from $231.5 billion in April 2015, an increase of 1.9 percent. Yet, much of that gain came from transportation equipment, particularly aircraft sales. Excluding transportation, new orders for durable goods increased just 0.4 percent, and over the past 12 months, that figure was down 1.4 percent. This suggests that demand remains somewhat weaker than the headline number would seem to indicate—a sign that durable goods manufacturers continue to be challenged beyond automobiles and aircraft.

Looking more closely at the April new orders data, the sector-by-sector analysis was somewhat mixed. On the positive side, there were increased sales for nondefense aircraft and parts (up 64.9 percent), fabricated metal products (up 3.1 percent), motor vehicles and parts (up 2.9 percent), computers and electronic products (up 1.9 percent) and electrical equipment and appliances (up 0.5 percent). In contrast, there were declining orders for defense aircraft and parts (down 4.5 percent), machinery (down 1.9 percent) and other durable goods (down 0.6 percent), with flat sales for primary metals. New orders for core capital goods (or nondefense capital goods excluding aircraft) declined 0.8 percent in April.

Meanwhile, durable goods shipments increased 0.6 percent in April, rebounding from two months of decreases. The strongest shipments growth for the month occurred in motor vehicles and parts (up 3.3 percent), nondefense aircraft and parts (up 2.8 percent), fabricated metal products (up 1.5 percent), electrical equipment and appliances (up 1.4 percent) and primary metals (up 0.6 percent). These increases were somewhat offset by declines for defense aircraft and parts (down 21.4 percent), other durable goods (down 0.6 percent), machinery (down 0.5 percent) and computers and electronic products (down 0.1 percent). Excluding transportation, durable goods shipments increased 0.4 percent, with core capital goods shipments up 0.3 percent.

The year-over-year data were similar to the new orders analysis discussed above, with each highlighting ongoing weaknesses in the sector. Since April 2015, durable goods shipments have fallen 1.2 percent, with a decline of 1.9 percent when excluding transportation equipment.

Gross Domestic Product (Revised)

The Bureau of Economic Analysis reported that the U.S. economy grew 0.8 percent in the first quarter of 2016, up from the prior estimate of 0.5 percent. The revision stemmed from better fixed investment, inventories and net exports data. Nonetheless, the economy remained challenged, with the improvements in these categories reducing the pace to which each was a drag on real GDP growth. Overall, U.S. economic growth has been disappointing through the first three months of 2016, extending the sluggishness at the end of 2015. Indeed, the underlying story remained the same as noted in the prior release. Consumers and businesses were cautious in the first quarter, dampening real GDP growth, and the strong U.S. dollar and struggling economies abroad meant that net exports subtracted from growth in the quarter.

We have become accustomed to having a bad first quarter followed by a strong rebound in the second quarter. In 2015, for instance, first and second quarter real GDP growth was 0.6 percent and 3.9 percent, respectively. I continue to expect a rebound in the current quarter as well, with my forecast for second quarter 2016 growth currently at 2.5 percent. For 2016 as a whole, I am predicting 2.0 percent growth.

Looking more closely at the first quarter data, consumer spending on goods was up just 0.4 percent at the annual rate, pulling back from 5.0 percent and 1.4 percent in the previous two quarters, respectively. As a result, goods spending added just 0.09 percent to real GDP growth. In contrast, service-sector spending by consumers contributed 1.20 percentage points to the headline number, making it one of the brighter spots in the latest report. The largest contributors were health care, housing and utilities, transportation services and other services.

Turning to business spending, nonresidential fixed investment fell an annualized 6.2 percent in the first quarter, extending the 2.1 percent decline in the fourth quarter. Spending on structures and equipment declined for the second straight quarter, with soft inventory growth serving as a drag for the third consecutive report. On a more positive note, residential spending grew at an annualized 17.1 percent in the first quarter, with the housing market continuing to move in the right direction overall. As a whole, gross private domestic investment fell 2.6 percent at the annual rate in the first quarter, subtracting 0.45 percentage points from real GDP growth. That was better than the 0.45 percent drag in the previous estimate.

Net exports also presented a challenge, as manufacturers and other businesses struggled to increase international demand. Goods exports were 2.6 percent at the annual rate. Goods exports have fallen in four of the past five months. At the same time, goods imports were off by less, down 1.1 percent for the quarter. As a result, net exports subtracted 0.21 percentage points from top-line GDP growth in the first quarter, which was an improvement from the 0.33 percent subtraction estimated earlier.

International Trade in Goods (Preliminary)

Preliminary data from the Census Bureau suggest that the goods trade deficit widened somewhat in April. The balance of goods traded increased from $55.62 billion in March to $57.53 billion in April. This was largely the result of an increase in goods imports, up from $172.76 billion to $176.82 billion, which outstripped a pickup in goods exports, up from $117.14 billion to $119.29 billion.

Goods exports were mostly higher, including gains for industrial supplies (up $1.58 billion), automotive vehicles (up $542 million), food, feeds and beverages (up $416 million), consumer goods (up $158 million) and capital goods (up $151 million). Outside of those categories, however, other goods exports were off by $697 million. At the same time, the story was very similar for goods imports. The largest increases for goods imports in April were for capital goods (up $2.02 billion), industrial supplies (up $1.31 billion), automotive vehicles (up $525 million) and consumer goods (up $427 million).

Final data on international trade for February will be released on June 3. Note that the U.S. trade deficit is also assisted by a surplus in service-sector activity, which was $18.07 billion in March. The final data will also include breakouts for petroleum trade and data on U.S.-manufactured goods exports.

Kansas City Fed Manufacturing Survey

The Kansas City Federal Reserve Bank reported that manufacturing activity continued to decline in May, contracting for the 15th straight month. The district continued to grapple with weaknesses in the agricultural and energy markets, with the strong dollar also challenging international demand. New orders (down from -2 to -3), production (down from -8 to -11), shipments (unchanged at -6), exports (down from -4 to -8), employment (down from -12 to -13) and the average employee workweek (down from -9 to -15) were all solidly in negative territory once again. Interestingly, respondents to this month’s survey were broken down into equally divided groups, with one-third experiencing higher sales, one-third seeing reduced sales and the remaining one-third reporting no change in May.

Meanwhile, the forward-looking data suggest manufacturers in the region are marginally positive about the next six months. The future-oriented composite index dropped from 10 to 4 but remained positive for the second straight month. The pace of growth for new orders (down from 20 to 15) and production (down from 25 to 15) remained decent moving forward, albeit with some easing in this release. At least 35 percent of respondents anticipate demand and output to improve in the second half of this year, with no more than 24 percent seeing declines. On the other hand, exports (down from 1 to -3), hiring (down from 8 to -4) and capital spending (up from -6 to -3) were each expected to decline over the next six months. This will likely mean that even with some optimism for better activity ahead, business leaders will remain cautious.

Markit Flash Manufacturing PMIs for the United States and Eurozone

U.S. manufacturing activity grew at its slowest pace since September 2009, according to Markit, rebuffing expectations of a possible rebound in May. The Markit Flash U.S. Manufacturing PMI declined from 50.8 in April to 50.5 in May. Reduced output (down from 50.3 to 49.1) helped to push the headline number lower, with production contracting for the first time since the Great Recession. In addition, exports fell at a slower rate (up from 48.6 to 49.6) but have contracted in three of the past four months.

With that said, new orders grew modestly (down from 52.0 to 51.6), with some easing in May, and hiring accelerated (up from 50.2 to 51.1). Overall, the Markit data stand in contrast to the more-upbeat results in the competing U.S. PMI survey from the ISM. The ISM survey has now expanded for two straight months, following five months of contraction, and it has helped to fuel talk of possible stabilization in the sector.

Meanwhile, the Markit Flash Eurozone Manufacturing PMI edged down from 51.7 to 51.5, a three-month low. The underlying data slowed across the board, including new orders (down from 52.1 to 52.0), output (down from 52.6 to 52.4), exports (down from 51.5 to 50.9) and employment (down from 51.6 to 51.4). Despite the easing, demand and production continued to expand modestly. At the same time, there were wide differences between preliminary manufacturing activity for Germany (up from 51.8 to 52.4) and France (down from 48.3 to 48.1), with the latter remaining mired in contraction territory, falling to a 13-month low.

New Home Sales

The Census Bureau and the U.S. Department of Housing and Urban Development reported that new residential sales jumped 16.6 percent, up from 531,000 units at the annual rate in March to 619,000 in April. That represented the strongest pace for new single-family home sales since January 2008, and it was further evidence that the housing market continues to move in the right direction. There were healthy gains in sales activity in every region except the Midwest, with the largest growth in the Northeast. Over the past 12 months, new home sales have grown 23.8 percent, up from 500,000 in April 2015.

The strong growth in new home sales in April meant that inventories were depleted, with the number of months of supply dropping from 5.5 months to 4.7 months. That represented a 14-month low for new home inventories. As a result, the median home sales price increased to $321,100, up 9.0 percent year-over-year.

Richmond Fed Manufacturing Survey

The Richmond Federal Reserve Bank reported that manufacturers saw reduced activity in May after experiencing decent expansions in both March and April. The composite index of general business activity declined from 14 in April to -1 in May, contracting for the first time since February. Shipments (down from 14 to -8), the backlog of orders (down from 11 to -13) and capacity utilization (down from 18 to -6) each returned to negative territory, and new orders (down from 18 to 0) stagnated for the month. On the other hand, the labor market variable continued to expand modestly, albeit with some easing in this report, including for hiring (down from 8 to 4) and the average workweek (down from 9 to 6).

Despite the current challenges, respondents to this month’s survey continued to expect relatively healthy increases in new orders (down from 24 to 20) and shipments (up from 22 to 24) over the next six months. Capacity utilization (down from 13 to 11) and capital expenditures (down from 22 to 10) were also anticipated to grow modestly moving forward, but at a slower pace than predicted in each of the past two months. With that said, employment levels (down from 10 to 2) and the average workweek (up from 1 to 3) were not anticipated to change much over the coming months. The small increases expected over the next six months on the labor front reflected ongoing cautiousness on the part of manufacturers in the region.

Meanwhile, inflationary pressures remained quite minimal, even with a pickup in input prices in May. Manufacturers in the region said that prices paid for raw materials grew 1.27 percent at the annual rate in May, up from 1.07 percent growth in April. Moving forward, raw material prices are expected to continue to grow modestly, up from 1.36 percent at the annual rate six months from now in the previous report to 1.47 percent this time.

University of Michigan Consumer Sentiment (Revised)

The University of Michigan and Thomson Reuters reported that consumer confidence improved in May after lulls in recent months. The Index of Consumer Sentiment jumped from 89.0 in April to 94.7 in May, its highest level since June 2015. It was previously estimated to be 95.8, but the data were encouraging nonetheless. Indeed, respondents were more upbeat about both the current (up from 106.7 to 109.9) and expected (up from 77.6 to 84.9) economic conditions. With that said, consumers remain somewhat cautious, with the headline index down from 98.1 in January 2015, a post-recessionary high.

University of Michigan Surveys of Consumers Chief Economist Richard Curtin noted that the data were consistent with 2.5 percent growth in consumer spending in 2016. He also cited uncertainties surrounding the election process as having a negative impact on confidence.

Connect with the Manufacturers

Questions or comments?

Contact Chief Economist Chad Moutray at cmoutray@nam.org.

Center for Manufacturing Research