

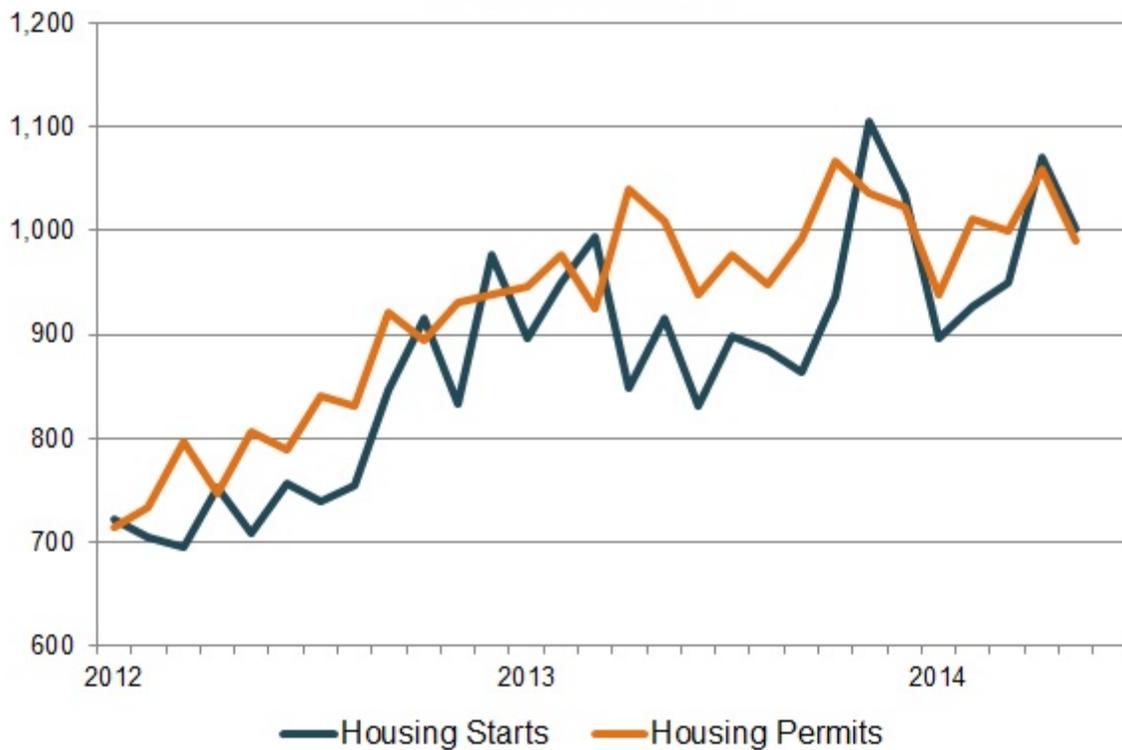
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June 23, 2014

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Housing Starts and Permits, 2012–2014 *(in thousands of units)*



The Federal Reserve Bank [downgraded](#) its estimates of growth for 2014, with real GDP growth of 2.1 percent to 2.3 percent. This was down from its March projection of 2.8 percent to 3.0 percent, largely due to weaknesses in the first quarter. Nonetheless, the Federal Reserve still projects a pickup in activity during the second half of the year that will continue into 2015, with an unchanged outlook of 3.0 percent to 3.2 percent growth next year. The unemployment rate is anticipated to fall to 6.0 percent by year's end and as low as 5.4 percent in 2015.

With that in mind, the Federal Open Market Committee (FOMC) [observed](#) that “growth in economic activity has rebounded in recent months,” even as it cited continued slack in the labor market. The FOMC continued to taper its asset purchases, down from \$45 billion per month to \$35 billion, and it mostly reiterated its intent to keep a highly accommodative monetary policy stance for the foreseeable future. Short-term interest rates are expected to start rising at some point next year. Yet, there is renewed chatter among “inflation hawks” about increased pricing pressures of late. [Core consumer prices](#), which exclude food and energy costs, rose 1.95 percent over the past 12 months, its fastest year-over-year pace in 19 months. While inflation still appears to be in check, the recent run-up in costs has fueled a debate about whether short-term rates might need to increase sooner than conventional wisdom might suggest.

For manufacturers, activity continues to recover from winter-related softness at the beginning of the year. [Manufacturing production](#) has risen 2.8 percent since January’s decline, with 3.6 percent growth over the past 12 months. Capacity utilization for the sector increased to 77.0 percent in May, its highest level since March 2008. Similarly, manufacturers in the [New York](#) and [Philadelphia](#) Federal Reserve districts reported strong growth in their respective June surveys. More importantly, respondents were mostly optimistic about future activity. More than half of those taking each survey said they anticipate increased new orders over the next six months. The Philadelphia Federal Reserve report also noted that 73.9 percent of its manufacturers predicted increased production in the second half of this year, with nearly 48 percent forecasting output growth of more than 4 percent.

Meanwhile, the housing market has provided mixed progress so far this year, even as we remain cautiously optimistic about future months. New [housing starts](#) decreased from an annualized 1,071,000 units in May to 1,001,000 in June. Despite the decline, it was the second straight month that starts have exceeded 1 million units, and the underlying trend remains positive. April’s figure was an outlier, with the year-to-date average being 969,000. As such, we continue to make slow-but-steady progress. At the same time, housing permits also declined, but single-family permitting increased from 597,000 units at the annual rate to 619,000, the fastest pace since November. This could be a sign that residential construction will accelerate in the months ahead. I still believe we will reach 1.1 million housing starts by year’s end. Moreover, [homebuilder confidence](#) was also higher for the month.

This week, we will get additional data on the health of the housing and manufacturing sectors. The Kansas City and Richmond Federal Reserve Banks will unveil their latest surveys, and Markit will release Flash Purchasing Managers’ Index (PMI) data for China, Japan, the Eurozone and the United States. We hope they will continue to reflect rebounding activity in the United States, and analysts will be closely following the June Chinese PMI data to see if the sector expands for the first time in 2014. The other key number to watch will be the second revision of real GDP for the first quarter. The consensus estimate is for the decline in output to exceed 1.5 percent, worse than the 1.0 percent decrease in the [first revision](#). Other highlights include new data on consumer confidence, durable goods orders and shipments, existing and new home sales and personal income and spending.

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Summaries fo Last Week`s Economic Indicators

Conference Board Leading Indicators

[The Conference Board reported that the Leading Economic Index \(LEI\) rose 0.5 percent in May, increasing for the fourth consecutive month.](#) So far this year, the LEI expanded 2.2 percent, which bodes well for future activity. In May, the largest contributors to the LEI were the stock market, favorable credit conditions, the interest rate spread and unemployment claims.

Manufacturing activity was a net positive in May, but it could have been stronger. The [average workweek](#) for production workers was longer, adding 0.13 percentage points to the LEI, but [new orders](#) were only up modestly, adding 0.04 percent overall. The biggest weakness in this month's LEI came from the decline in housing permits, subtracting 0.21 percentage points. Still, single-family housing permitting was higher, making the news on residential construction more encouraging than the headline figure might suggest (see below).

Meanwhile, the Coincident Economic Index (CEI), which assesses current conditions, increased 0.3 percent in May. The index has now risen for four straight months. Year-to-date, the CEI has grown 1.1 percent, perhaps showing the slower-than-desired pace of economic activity during the first half of 2014. Nonetheless, all four subcomponents of the CEI made positive contributions for the month, including industrial production (see below), [nonfarm payrolls](#), [personal income](#) and [manufacturing and trade sales](#).

Consumer Price Index

[The Bureau of Labor Statistics reported that consumer prices increased 0.4 percent in May, their strongest monthly gain since February 2013.](#) Food and energy costs both accelerated in May, helping to push the overall consumer price index higher. The cost of energy soared 0.9 percent for the month, accelerating on rising electricity (up 2.3 percent) and gasoline (0.7 percent) expenses. The jump in electricity prices followed a 2.6 percent decline the month before; on a year-over-year basis, electricity costs have risen modestly, up 3.6 percent.

Meanwhile, food prices continue to rise, up 0.5 percent in May and 1.8 percent over the past five months. The increase was mainly attributable to increased costs for meats, seafood, eggs, dairy and vegetables. Outside of food and energy, the largest increases were for apparel, lodging away from home, housing, transportation services, medical care and new vehicles.

The consumer price index has risen 2.1 percent over the past 12 months, up significantly from the 1.1 percent pace just three months ago in February. Core inflation, excluding food and energy costs, was up 1.95 percent year-over-year, up from 1.8 percent the month before. As such, core pricing pressures have neared the 2 percent threshold set by the Federal Reserve Board, and May's year-over-year pace was the highest level in 19 months.

At least for now, pricing pressures appear to be in check, hovering around the Federal Reserve's stated target. Yet, the Federal Reserve will also keep a close eye on it to see if core pricing pressures continue to accelerate in the months ahead. I predict they will stabilize somewhat, and some of the current pressures are transitory in the short term.

Housing Starts and Permits

[The Census Bureau and the U.S. Department of Housing and Urban Development reported that housing starts and permits both declined in May.](#) New housing starts decreased from an annualized 1,071,000 units in April to 1,001,000 in May, with the annual pace staying above 1 million for the second straight month. The average pace for new housing starts so far in the first five months of 2014 was 969,000, suggesting that we continue to make slow-but-steady progress on the residential front. It also appears that April's jump was a bit of an outlier. Nonetheless, housing starts have increased 9.4 percent since May 2013.

Much of the volatility over the past few months has come from the multifamily housing segment, which has hovered between an annualized 314,000 in January to April's 407,000. In May, multifamily housing starts declined to 376,000 units. Perhaps more disappointingly, single-family starts were also lower for the month, down from 664,000 to 625,000. This was the lowest level since February and highlights some persistent softness in the residential construction market, even as the longer-term trend continues to edge slightly higher. For instance, single-family housing starts remain 4.7 percent higher on a year-over-year basis even as the pace remains below the more rapid rates at the end of 2013.

Meanwhile, housing permits data also fell, down from 1,059,000 units at the annual rate to 991,000. Yet, the permitting data, which suggest future activity for residential construction, were perhaps more encouraging than the headline figure might suggest, particularly for single-family homes. Single-family housing permits increased from 597,000 in April to 619,000 in May, their fastest pace since November. At the same time, multifamily permitting declined from 462,000 to 372,000, pushing the overall numbers lower.

Overall, May's housing numbers provided mixed news. New residential starts and permits were both lower in May, and single-family starts were off 5.9 percent for the month. Still, single-family permitting moved higher, which should indicate more construction down the line. Moreover, the longer-term trend remains positive, even as growth has slowed significantly since mid-2013. I continue to predict housing starts of 1.1 million by year's end, but higher interest rates, financial difficulties in obtaining credit (particularly for first-time homebuyers) and economic uncertainties will continue to dampen growth.

Industrial Production

[Manufacturing production increased 0.6 percent in May, rebounding from a revised 0.1 percent decline in April, according to the Federal Reserve Board.](#) We have seen relatively strong growth in the manufacturing sector since January's winter-related decreases in output. Manufacturing production has risen 2.8 percent since January, with 3.6 percent growth over the past 12 months. That was the fastest year-over-year pace for the sector since October.

Capacity utilization for manufacturers also increased for the month, up from 76.7 percent in April to 77.0 percent in May. That was the highest level since March 2008, continuing a trend of reaching near pre-recessionary paces nearly five years after the economic recovery began. Still, on a year-over-year basis, manufacturing capacity has grown just 1.4 percent, which leaves room for improvement.

In May, durable goods production growth (0.9 percent) outpaced nondurable goods activity (0.4 percent). In all, 12 of the 19 major sectors experienced output gains for the month, with most of the declines in nondurable goods segments. The largest production increases were plastics and rubber products (up 1.8 percent), wood products (up 1.7 percent), motor vehicles and parts (up 1.5 percent), petroleum and coal products (up 1.3 percent), electrical equipment and appliances (up 1.1 percent) and machinery (up 1.1 percent).

In contrast, textile and product mills (down 0.9 percent), paper (down 0.5 percent), apparel and leather products (down 0.4 percent), food, beverage and tobacco products (down 0.3 percent), primary metals (down 0.1 percent) and printing and support (down 0.1 percent) had lower production in May.

On a year-over-year basis, durable goods production jumped from 4.7 percent in April to 5.3 percent in May, and it has risen steadily since bottoming out at 3.1 percent in January. Several durable goods sectors have experienced robust growth over the past year, including motor vehicles and parts (up 7.7 percent), machinery (up 7.6 percent), furniture and related products (up 6.7 percent) and wood products (up 6.2 percent). At the same time, nondurable goods output rose 2.2 percent over the past 12 months, up from 0.3 percent in January and 2.0 percent in April. The fastest annual growth in the nondurable goods space was plastics and rubber products (up 5.9 percent).

Meanwhile, overall industrial production rose 0.6 percent in May, recovering from the 0.3 percent drop in April. In addition to the gain from manufacturing for the month, mining output also grew strongly (up 1.3 percent). Yet, utility production dropped for the fourth straight month (down 0.8 percent). Total capacity utilization increased from 78.9 percent to 79.1 percent, with year-over-year growth of 2.4 percent.

NAHB Housing Market Index

[The Housing Market Index \(HMI\) from the National Association of Home Builders \(NAHB\) and Wells Fargo reflected signs of slight improvement.](#) The HMI increased from 45 in May to 49 in June, its highest point since January. Much of this progress stemmed from higher homebuilder sentiment in the Midwest, South and West, particularly the latter two. More importantly, the index of single-family sales increased from 48 to 54, with expected sales over the next six months rising from 56 to 59. The fact that these figures are greater than 50 indicates that more builders are positive than negative.

Even with these positive developments, NAHB Chief Economist David Crowe noted the tentativeness that still exists in the marketplace. He said, "Consumers are still hesitant and are waiting for clear signals of full-fledged economic recovery before making a home purchase." Such caution, he noted, has led homebuilders to adjust their plans as a result.

New York Fed Empire State Manufacturing Survey

[The Empire State Manufacturing Survey from the New York Federal Reserve Bank continued to reflect strong growth in June.](#) The composite index of general business conditions remained elevated, up from 19.0 in May to 19.3 in June, essentially sustaining the sharp increase from the month before. In all, slightly more than 40 percent of survey respondents said business conditions were better in June, with 21.1 percent suggesting they had worsened. Similar to last month, this was the fastest pace for the composite index since June 2010.

A nice jump in sales helped to push manufacturing sentiment higher for the month, with the new orders index rising from 10.4 in May to 18.4 in June. The percentage of respondents who reported increasing new orders rose from 31.9 percent to 40.7 percent. The length of the average workweek also widened (up from 2.2 to 9.7). Still, there was some easing in other components, including shipments (down from 17.4 to 14.2) and

employment (down from 20.9 to 10.8). The latter suggests a slight deceleration in hiring, but still a decent pace.

Looking ahead six months, manufacturers in the district continued to be mostly optimistic. While the forward-looking composite index eased slightly for the month (down from 44.0 to 39.8), this figure still indicates strong growth over the next six months, and other figures suggest accelerating activity levels. For instance, new orders (up from 36.7 to 44.5), shipments (up from 33.8 to 45.2) and hiring (up from 17.6 to 20.4) are all expected to pick up in the coming months. Indeed, 55.4 percent anticipate increased new orders over the next six months.

On the downside, the average employee workweek is anticipated to be flat (up from -3.3 to zero) moving forward, and capital expenditures (down from 19.8 to 11.8) and technology spending (down from 4.4 to 3.2) both eased this month. More than one-quarter of respondents still plan to increase capital spending in the months ahead, but these figures suggest some cautiousness on the investment side.

Philadelphia Fed Manufacturing Survey

[The Federal Reserve Bank of Philadelphia reported that manufacturing activity expanded strongly in June, extending the spring rebound in the region.](#) The Business Outlook Survey's composite index of general business activity increased from 15.4 in May to 17.8 in June, averaging 16.6 over the past three months. The underlying numbers were mostly positive. There were faster rates of growth for new orders (up from 10.5 to 16.8), shipments (up from 14.2 to 15.5), hiring (up from 7.8 to 11.9) and the average workweek (up from 2.9 to 7.3). More than 39 percent of respondents said that new orders were higher in the month, up from 34.8 percent in the prior survey.

Pricing pressures remain elevated, with raw material costs continuing to edge higher. The index for prices paid rose from 23.0 to 35.0, with 36.2 percent of respondents suggesting that input costs had increased in June. Just more than 60 percent said that raw material prices were unchanged, with just 1.2 percent indicating a decline. Moving forward six months, 44.5 percent anticipate their costs to rise, with none expecting them to fall. For the most part, this mirrors the recent [producer price index](#) data, which have shown core inflation picking up somewhat.

Looking toward the second half of 2014, manufacturers in the district were mostly upbeat. In a special question on production expectations, 73.9 percent of respondents said they anticipate increased production in the coming months, with nearly 48 percent predicting output growth of more than 4 percent. This corresponds with 59.7 percent who predict increased new orders over the next six months.

Employment growth is also expected to increase, but with some mixed news overall. The good news is that 29.0 percent said they plan to hire additional workers. Yet, that figure is slightly dwarfed by those who do not intend to hire but plan to increase output through productivity gains (27.5 percent) or more hours for existing staff (11.6 percent). This suggests that firms remain slightly hesitant about adding to their workforce, even as we have seen progress of late on the employment front.

State Employment Report

[The Bureau of Labor Statistics reported that Michigan added the most net new jobs in May, hiring an additional 4,500 workers for the month.](#) This speaks to the continued rebound of the automotive sector, which added 5,000 employees nationally in May and 10,100 year-to-date. Other states with the most manufacturing jobs hired in May included Minnesota (up 2,900), Ohio (up 2,900), Missouri (up 2,100), Texas (up 1,500) and South Carolina (up 1,400).

Many of these same states saw the biggest gains in manufacturing employment through the first five months of 2014. For instance, Ohio had the largest employment gains among manufacturers year-to-date, adding 7,300 workers on net from January through May. Missouri (up 6,100), Minnesota (up 5,700), Indiana (up 5,100) and Texas (up 5,000) rounded out the top-five states.

Looking at unemployment, the state with the lowest rate continues to be North Dakota (2.6 percent), with shale exploration helping to propel economic growth. Vermont (3.3 percent), Nebraska (3.6 percent), Utah (3.6 percent), South Dakota (3.8 percent) and Wyoming (3.8 percent) also have very low unemployment rates. At the other end of the spectrum, the state with the highest unemployment rate was Rhode Island (8.2 percent), closely followed by Nevada (7.9 percent), Kentucky (7.7 percent), Mississippi (7.7 percent) and California (7.6 percent).

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Questions or comments?

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