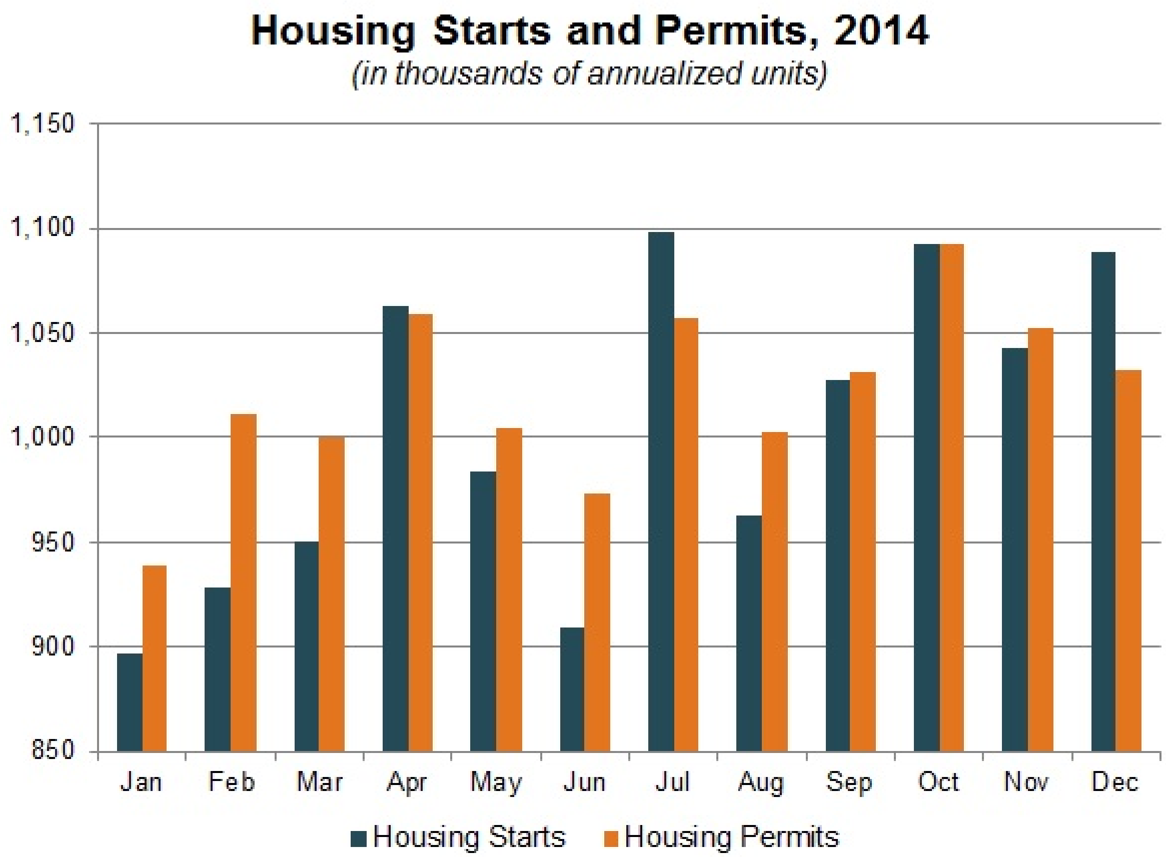
A Publication of the National Association of Manufacturers

Monday Economic Report

January 26, 2015



The European Central Bank (ECB) finally announced its long-awaited quantitative easing program on Thursday. The ECB will purchase 60 million euros in bonds each month until September 2016—totaling at least 1.1 trillion euros overall—in an attempt to stimulate growth. Depending on where the Eurozone economy stands pointing September 2016, the ECB might extend its purchasing beyond that point. The impact on the euro was almost immediate, with the euro exchanging for $1.1206 at Friday's close, down from $1.3927 on March 17, the high point of 2014. This will complicate manufacturers' ability to sell goods into Europe, something that was mentioned in the sample comments in the latest Kansas City Federal Reserve Bank's monthly survey (see below).

The ECB believes that it needs to act to stimulate economic growth in the Eurozone. Real GDP in the Eurozone is expected to grow about one percent in 2015, and deflation has been a top concern. Indeed, the annual inflation rate declined by 0.2 percent in December, a troublesome development. On the positive side, some signs indicate that the European manufacturing sector has started to stabilize. The Markit Flash Eurozone Manufacturing purchasing managers' index (PMI) increased to its highest level since July. It was up from 50.6 in December to 51.0 in January on stronger new orders, output and employment growth. Investors were also more optimistic, brushing off anxieties that have plagued European financial markets of late.

The other manufacturing surveys released last week were mixed. In China, for instance, the HSBC Flash Manufacturing PMI found that new orders and output grew once again in January after contracting in December. Yet, the headline PMI figure has now contracted for two straight months, and real GDP grew 7.3 percent year-over-year in the fourth quarter, decelerating from 7.7 percent growth in the fourth quarter of 2013.

Likewise, surveys of manufacturers in the United States reflected continued expansion in the new year, but at a somewhat softer pace of growth. The Markit Flash U.S. Manufacturing PMI declined from 53.9 to 53.7, its lowest reading in 12 months. Still, these figures also show demand and production expanding at a relatively strong rate, even with some easing in this month's responses. Similarly, manufacturers in the Kansas City Fed's district are mostly optimistic in their outlook for the next six months for sales, production, shipments, hiring and capital spending, but they remain uncertain about exports, which are threatened by sluggish economic growth overseas and the strong dollar.

Meanwhile, housing starts rebounded in December to 1,089,000 annualized units. New residential construction units started averaged just over 1,050,000 in the second half of 2014, which was a nice improvement from the roughly 955,000 observed in the first half of the year. Single-family activity provided the encouraging news in this data, rising to 728,000 units in December, the fastest pace since 2008. As such, we have seen slow-but-steady progress in the housing market, and I continue to expect 1.1 million housing starts in the coming months. For their part, home builders remain confident about future activity. In contrast to single-family units, multi-family starts and permits—each of which were lower in December—have grown more minimally and with a lot more volatility. Existing home sales were up in December, but remain below their October peak. On the positive side, sales of existing homes were up 3.5 percent year-over-year, and median prices were at their highest level since 2007.

Two of the larger headlines this week will be the Federal Open Market Committee policy statement on Wednesday and our first read on fourth quarter real GDP on Friday. Beyond those headlines, we will also get a number of reports on the health of the manufacturing sector, such as the Dallas Federal Reserve Bank survey on Monday and the Richmond Fed survey and preliminary durable goods orders numbers on Tuesday. Other highlights include the latest figures on consumer confidence, employment costs and state employment.

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Economic Indicators

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MLK HOLIDAY

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This Week's Indicators:

Monday, January 26
Dallas Fed Manufacturing Survey

Tuesday, January 27
Conference Board Consumer Confidence
Durable Goods Orders and Shipments
Richmond Fed Manufacturing Survey
State Employment Report

Wednesday, January 28
FOMC Monetary Policy Statement

Thursday, January 29
None

Friday, January 30
Employment Cost Index
Gross Domestic Product (Fourth Quarter 2014)
University of Michigan Consumer Sentiment (Revised)

Summaries for Last Week`s Economic Indicators

Chicago Fed National Activity Index
The Chicago Federal Reserve Bank reported that the U.S. economy softened a bit in December. The National Activity Index (NAI) declined from a robust 0.92 in November to -0.05 in December. Positive figures indicate that the economy is growing above its historical growth rate while negative numbers suggest the opposite. Of course, monthly data can be quite volatile, so it is also interesting to look at the three-month moving average, which decreased from 0.54 to 0.39. As such, the NAI can be interpreted as showing continued strength in the economy, even as there was weaker-than-desired activity in some measures in December.

Manufacturing was one such area, with manufacturing production slowing in December. Total industrial production declined for the month for the first time since August. The longer-term trend was more encouraging, however, with manufacturing output up a relatively strong 4.9 percent year-over-year. Housing permits (see below) and retail sales figures were other examples of softer data points in December, even though each saw improvements from prior months. Employment was a bright spot, with the unemployment rate falling to 5.6 percent and nonfarm payrolls exceeding 200,000 in December for the 11th straight month.

Conference Board Leading Indicators
The Conference Board reported that the Leading Economic Index (LEI) rose 0.5 percent in December, the fourth straight monthly increase. In the second half of 2014, the LEI increased 3.3 percent, hopefully predicting healthy growth in the U.S. economy over the coming months. In December, manufacturing new orders provided a positive contribution to the LEI, but not as much as they did in November. This mirrored some easing in demand seen in the Institute for Supply Management’s report for December, even as new orders growth remained relatively strong. Other positive elements to this month’s LEI were initial

unemployment claims, the stock market, consumer confidence, favorable credit conditions and the interest rate spread.

Meanwhile, the Coincident Economic Index (CEI), which assesses current conditions, was up 0.2 percent in December. This was down from the 0.5 percent gain observed in November. The manufacturing sector was largely responsible for the slower pace, with production easing in the month. Manufacturing production increased 0.3 percent in December, down from 1.3 percent in November. The other three subcomponents of the CEI—nonfarm payrolls, personal income, and manufacturing and trade sales— made positive contributions in December.

Existing Home Sales

The National Association of Realtors® (NAR) reported that existing home sales increased 2.4 percent in December, rebounding somewhat from weakness in November. There were 5.04 million homes sold at the annual rate in December, up from 4.92 million in November. Nonetheless, the overall trend was mixed. On a year-over-year basis, existing home sales rose 3.5 percent, yet December's pace was off from October's 5.25 million rate, the high point of 2014. Moreover, growth was primarily with single-family homes, with condo sales essentially flat over the past 12 months.

In December, existing home sales were higher in the South and West, but weaker in the Midwest and Northeast. There was less inventory on the market, with the number of months of supply dropping from 5.1 months in November to 4.4 months in December. That could help to push up prices. The median price for an existing home sale in December was $209,500. The NAR reported that median home prices last year rose to their highest level since 2007, averaging $208,500 in 2014 and up 5.8 percent from 2013.

Housing Starts and Permits

The Census Bureau and the U.S. Department of Housing and Urban Development reported that new residential construction rebounded in December. New housing starts rose from an annualized 1,043,000 in November to 1,089,000 in December. These data have been up and down for much of the second half of 2014, with December's value not far from October's 1,092,000 reading. The underlying story, however, is one of progress. Housing starts averaged 1,052,167 in the second half of 2014, which was a nice improvement from the 955,167 average observed in the first half of the year. I continue to predict that housing starts will exceed 1.1 million in the coming months, and this latest data are relatively close to that mark.

The growth in housing starts in December stemmed largely from single-family activity, up from 679,000 to 728,000 for the month. This was the fastest pace since March 2008. Starts averaged 613,833 and 679,833 in the first and second halves of 2014, respectively, or an annual rate of 646,833 for 2014 as a whole. This represented slight progress from the 621,083 rate of 2013.

In contrast, the highly volatile multi-family segment edged somewhat lower, down from 364,000 in November to 361,000 in December. This number ranged widely all year, from a low of 314,000 in January to 446,000 in July. For 2014 as a whole, multi-family housing starts averaged 356,833. While this was better than the 308,583 average for 2013, it should be noted that multi-family starts were 359,000 in December 2013, signifying minimal year-over-year growth.

Meanwhile, housing permits declined for the second straight month, down from an annualized 1,052,000 in November to 1,032,000 in December. Total permitting exceeded one million in 10 of the 12 months of 2014, and the longer-term trend remains positive. Housing permits averaged 1,044,500 in the second half of the year, up from 997,833 in the first half. The underlying December data were mixed, with single-family permits higher, up from 638,000 to 667,000, but multi-family activity lower, down from 414,000 to 365,000. Single-family permits were the highest since January 2008. The multi-family data were a little harder to interpret, with just incremental progress over the course of the year (up from an average of 391,667 in the first half to 404,333 in the second half).

Overall, these data indicate upward movement in the housing market, with slow-but-steady progress.

Kansas City Fed Manufacturing Survey

The Kansas City Federal Reserve Bank reported that manufacturing activity slowed in January, beginning the new year on a softer note. The composite index of general business conditions dropped from 8 in December to 3 in January, its lowest level in five months. Underlying this figure, new orders (down from 14 to -8), production (down from 7 to -2), shipments (down from 8 to -5) and exports (down from zero to -7) declined, and hiring (down from 8 to zero) stagnated. On the positive side, it was the 13th straight month with expanding levels of sentiment, and manufacturers remain mostly optimistic about the coming months.

The data on the current economic environment reflect a number of challenges, as observed in the sample comments. One respondent cited the strengthening U.S. dollar and alluded to the West Coast ports slowdown, writing, “The strong dollar is really hurting our ability to compete with our European competitors. Also, shipping delays out of Long Beach port are causing us issues with getting our product to our customers timely as well as getting product to us from China timely.” The other issue of note was falling petroleum prices, particularly as they relate to the energy supply chain. As one individual put it, “Lower oil prices have reduced our transportation costs but hurt the business prospects for some of our customers that serve the oil extraction industry.”

Despite these challenges, the outlook for manufacturers in the Kansas City Fed district remained encouraging. The future-oriented composite index was unchanged at 19, a figure that suggests a relatively decent expansion moving forward. In fact, measures for new orders (up from 23 to 24), production (up from 26 to 27) and shipments (up from 33 to 35) strengthened slightly in January. While anticipated hiring (down from 30 to 24) and capital spending (down from 25 to 16) plans each eased a bit this month, the data continue to indicate healthy gains for both. In contrast, export sales (down from 8 to -2) were not expected to improve over the next six months, making exports the largest downside risk moving forward in this survey.

Markit Flash PMIs for China, the Eurozone and the U.S.

Even as the global economy remains soft, there were some signs of stabilization in Asia and Europe, according to the most recent purchasing managers’ index (PMI) data. The Markit Flash Eurozone Manufacturing PMI increased from 50.6 in December to 51.0 in January. This was the highest level since July. The pace of growth for new orders (up from 50.2 to 50.4), output (up from 50.9 to 52.2) and employment (up from 50.6 to 50.9) each picked up somewhat. At the same time, exports (down from 51.6 to 50.7) eased slightly but continued to expand.

Despite the improvement in sentiment in this month’s PMI figures, economic growth in Europe remains sluggish. Real GDP in the Eurozone is expected to grow about one percent in 2015, and deflation has been a top concern at the European Central Bank (ECB). With that in mind, the ECB announced that it would purchase 60 million euros in bonds each month until September 2016 in an attempt to stimulate growth. Its quantitative easing program will total at least 1.1 trillion euros and could be extended beyond September 2016. The impact on the euro was almost immediate, with the euro exchanging for $1.1206 at Friday’s close, down from $1.3927 on March 17, the high point of 2014.

Meanwhile, the HSBC Flash China Manufacturing PMI rose from 49.6 to 49.8. This was the second consecutive monthly contraction in activity, which has essentially stalled. The good news, however, was that both new orders (up from 49.7 to 50.8) and output (up from 49.9 to 50.1) shifted to ever-so-slight growth in January after contracting in December. On the other hand, export sales growth (down from 51.5 to 51.1) decelerated a bit, and hiring (down from 49.3 to 49.1) declined further.

Earlier in the week, the Chinese National Bureau of Statistics reported that real GDP grew 7.3 percent year-over-year in the fourth quarter, unchanged from the third quarter but representing a deceleration from 7.7 percent growth in the fourth quarter of 2013. Clearly, the Chinese economy continues to see slower rates of growth—albeit healthy figures by our standards—than in past years. I expect real GDP in China to expand by 7 percent in 2015.

In contrast to weaknesses in other regions, the United States has been a bright spot. Still, we saw softer data in December and January in some measures, including the latest Markit Flash U.S. Manufacturing PMI data, which were down from 53.9 to 53.7. This was the lowest index reading in 12 months, suggesting some moderation in sentiment from the index's 2014 peak of 57.9 in August. The January data were mixed. Output (up from 54.7 to 55.1) and hiring (up from 53.0 to 53.4) strengthened slightly whereas new orders (down from 55.4 to 54.7) eased a little. Nonetheless, the sector continues to experience strong growth in demand and production, albeit with some easing in the pace of late.

NAHB Housing Market Index

The National Association of Home Builders (NAHB) and Wells Fargo reported that builder confidence eased slightly in January. The Housing Market Index (HMI) dropped from a revised 58 in December to 57 in January. The good news was that the index has remained above 50 for seven straight months, signifying that more builders are optimistic than pessimistic in their outlook. Since June, the HMI has averaged 56.3, an improvement from the 48.0 average seen in the first half of 2014. As such, home builders continue to report progress after softness earlier last year.

Looking specifically at the January data, home builders grew more confidence in the Midwest, but there was some easing in sentiment in other regions. Respondents remained mostly upbeat about the next six months, even as the forward-looking measure of expected single-family home sales declined from 64 to 60 for the month.

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Questions or comments?

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